



**WORKING PAPER**

# **Financial Inclusion, Stability, Integrity, and Protection:**

**Observations and Lessons for the I-SIP  
Approach from the Philippines**

April 2017



# TABLE OF CONTENTS

CURRENCY AND EQUIVALENT UNITS .....	IV
ABBREVIATIONS .....	IV
ACKNOWLEDGMENTS .....	VII
<b>1. INTRODUCTION: THE I-SIP APPROACH .....</b>	<b>1</b>
1.1 Background .....	1
1.2 Research approach.....	2
1.3 I-SIP research exercise in the Philippines .....	4
1.4 This report.....	5
<b>2. STATE OF FINANCIAL INCLUSION IN THE PHILIPPINES.....</b>	<b>6</b>
2.1 The Philippines' commitment to financial inclusion.....	6
2.2 Key access and usage data .....	7
2.3 Definition and measurement of financial inclusion in the Philippines.....	10
<b>3. ANALYSIS OF POLICY INTERVENTIONS .....</b>	<b>11</b>
3.1 Mandated agricultural credit.....	11
3.2 National Strategy for Microfinance .....	20
3.3 Electronic money guidelines.....	29
3.4 Regulations for microbanking offices .....	37
3.5 Draft regulations for pawnshops .....	44
3.6 Summary of linkages in policy interventions .....	52
<b>4. OBSERVATIONS ON THE PHILIPPINES I-SIP AND NEXT STEPS.....</b>	<b>54</b>
4.1. Observations vis-à-vis the I-SIP Propositions .....	54
4.2. Next steps.....	60
<b>ANNEX 1. INTERVIEWS .....</b>	<b>61</b>
<b>ANNEX 2. FINANCIAL SERVICES ACCESS POINTS     IN THE PHILIPPINES .....</b>	<b>65</b>
<b>REFERENCES .....</b>	<b>68</b>

## CURRENCY AND EQUIVALENT UNITS

(As of February 29, 2016)

Currency Unit = Philippine peso (PhP)

US\$ 1 = PhP 47.56

## ABBREVIATIONS

4Ps	Pantawid Pamilyang Pilipino Program
AGFP	Agricultural Guarantee Fund Pool
AML	Anti-Money laundering
AMLCS	Anti-Money Laundering Council Secretariat
ASEAN	Association of Southeast Asian Nations
ATM	Automated Teller Machine
BAP	Bankers Association of the Philippines
BFA	Bankable Frontier Associates
BSP	Bangko Sentral ng Pilipinas
CALG	Central Applications and Licensing Group
CAMELS	Capital adequacy, Asset quality, Management, Earnings, Liquidity, Sensitivity to market risks
CDA	Cooperative Development Authority
CEO	Chief Executive Officer
CEBG	Card and e-Banking Group
CFT	Combating the Financing of Terrorism
CGAP	Consultative Group to Assist the Poor
CPIP	Credit Policy Improvement Program
DFID	United Kingdom Department for International Development
DOF	Department of Finance
DSWD	Department of Social Welfare and Development
DTI	Department of Trade and Industry
EMI	Electronic money issuer
FATF	Financial Action Task Force

FCPD	Financial Consumer Protection Department
G2P	Government to Person
GPFI	Global Partnership for Financial Inclusion
GSMA	GSM Association
GXI	G-Xchange, Inc.
IC	Insurance Commission
IMF	International Monetary Fund
I-SIP	Inclusion, Stability, Integrity, Protection
KYC	Know Your Customer
LBP	Land Bank of the Philippines
LCDP	Loan Collection and Disbursement Point
MBO	Microbanking Office
MCPI	Microfinance Council of the Philippines, Inc.
MFI	Microfinance Institution
MiDAS	Microfinance Data Sharing System
MORNBFi	Manual of Regulations for Non-bank Financial Institutions
MSME	Micro, Small, and Medium-Sized Enterprises
NBFI	Nonbank Financial Institution
NCCT	Non-Cooperative Countries and Territories
NGO	Nongovernmental Organization
NPL	Nonperforming Loans
NSSLA	Nonstock Savings and Loan Association
NTC	National Telecommunications Commission
OBO	Other Banking Office
PCFC	People's Credit and Finance Corporation
PCIC	Philippine Crop Insurance Corporation
PDIC	Philippine Deposit Insurance Corporation
PDR	People's Democratic Republic
PESO	Portfolio quality, Efficiency, Sustainability, Outreach

RA	Republic Act
ROA	Return on Assets
ROE	Return on Equity
SEC	Securities and Exchange Commission
SIM	Subscriber Identification Module
SMS	Short Message Service
SSB	Standard-Setting Body
TILA	Truth in Lending Act
TSS	Technical Support Services
UN	United Nations
USAID	United States Agency for International Development

## ACKNOWLEDGMENTS

This study was conducted at the request of Bangko Sentral ng Pilipinas (BSP), the central bank of the Philippines. The objective of the study was to analyze how the linkages among financial inclusion, stability, integrity, and consumer protection have been managed in the case of four existing policies (mandated agricultural credit, National Strategy for Microfinance, electronic money guidelines, and regulations for microbanking offices) and one policy to be implemented (draft regulations for pawnshops). The study includes the results of a visit from a Consultative Group to Assist the Poor (CGAP) team to the Philippines 11–20 August 2015 and a follow-up analysis covering developments through February 2016.

This study was conducted by a joint research team from CGAP and BSP. The team was led by Olga Tomilova and included Eric Duflos, Juan Carlos Izaguirre, and Myra Valenzuela (all CGAP), and Pia Roman Tayag, Rochelle Tomas, Mary Ann Cuevas, and Mynard Mojica (all BSP). Overall guidance was provided by Timothy Lyman, Katharine Lauer, Stefan Staschen (all CGAP), and Nestor Espenilla (BSP).

The team wishes to express its gratitude to BSP for its strong support and assistance during this visit, and to the wide range of stakeholders from government, private, and nonprofit sectors who contributed to the study through interviews. A complete list of persons interviewed is presented in Annex 1.

*No endorsement of this report was sought from any party, nor should any be inferred from participation in the consultative process by which it was developed.*



## 1. INTRODUCTION: THE I-SIP APPROACH

### 1.1 Background

Financial-sector policy makers and international standard-setting bodies (SSBs) have traditionally sought to create the conditions for financial stability. Over the past two decades increasingly more attention has been paid to financial integrity (i.e., preventing financial crimes through, for example, anti-money laundering [AML] and combating the financing of terrorism [CFT] programs) and financial consumer protection, particularly in the wake of the 2008–2009 global financial crisis. Financial inclusion—a more recent addition to the list of core policy objectives for financial-sector regulation and supervision—has received increasing global recognition by the United Nations, G20 Leaders and Finance Ministers/Central Bank Governors, SSBs, and other global bodies. Moreover, financial inclusion has found its way into country-level policy making. Relevant policy-making bodies in more than 50 countries around the world have committed to measurable targets for improving financial inclusion domestically under the Maya Declaration, the Alliance for Financial Inclusion’s initiative to encourage national commitments to financial inclusion.<sup>1</sup>

In collaboration with many such actors, in 2011 CGAP embarked on a work stream aimed at understanding how policy making changes when financial inclusion is added as a core objective—and more specifically how the four policy objectives (**I** for financial inclusion, **S** for financial stability, **I** for financial integrity, and **P** for financial consumer protection [I-SIP])

are linked and how policy makers can optimize the linkages to minimize tradeoffs and other negative outcomes and to maximize synergies. This work stream builds the evidence base to implement a call by the G20 Finance Ministers and Central Bank Governors in their November 2012 communiqué for SSBs to provide guidance and engage with the G20 Global Partnership for Financial Inclusion (GPII) to study the I-SIP linkages.<sup>2</sup>

The original concept for the study was developed by Martin Alsup (United Kingdom Department for International Development [DFID]), Timothy Lyman (CGAP), and David Porteous (Bankable Frontier Associates [BFA]). DFID, in its capacity as Co-Chair of the GPII Subgroup focused on engagement with the SSBs, funded CGAP (a GPII Implementing Partner) to conduct an initial research exercise in South Africa to inform the work of the Subgroup. In 2012, CGAP carried out a pilot research exercise in South Africa to begin developing a framework to study I-SIP linkages in the context of country-level policy making, to gain deeper understanding on whether and how the I-SIP objectives can be mutually reinforcing, and ultimately to confirm that increased financial inclusion can result in a positive (or at least no negative) effect on the other three objectives. CGAP also sought to develop a methodology to help policy makers optimize the linkages in practice. As a result of this work, CGAP formulated the I-SIP Approach to designing or adjusting financial-sector policies that involves identifying, managing, and optimizing the linkages among the I-SIP

1 The Alliance for Financial Inclusion is an international network of policy makers and regulators committed to promoting financial inclusion. See <http://www.afi-global.org/maya-declaration>.

2 GPII was created in 2010 as an inclusive platform for all G20 countries, interested non-G20 countries, and relevant stakeholders to carry forward work on financial inclusion, including implementation of the G20 Financial Inclusion Action Plan (<http://www.gpii.org/about-gpii>). The terms of reference and work plan of the GPII Subgroup on Regulation and SSBs provide further details on GPII’s work with SSBs (<http://www.gpii.org/subgroup-regulation-and-standard-setting-bodies>).

objectives triggered by a given policy intervention. To guide policy makers on how to implement the I-SIP Approach more effectively, CGAP proposed a set of I-SIP Propositions (Box 1).<sup>3</sup> To advance the understanding of the linkages among the I-SIP objectives and to refine the I-SIP Approach, similar research

exercises were undertaken in Pakistan (2013) and in Russia (2013–2014).

## 1.2 Research Approach<sup>4</sup>

A growing body of research including the four I-SIP research exercises conducted by CGAP suggests that whether broad-

### BOX 1. The I-SIP Approach and Propositions

**I-SIP Approach.** To optimize policy outcomes, policy makers should seek to identify and analyze the linkages among financial inclusion, stability, integrity, and protection (the I-SIP objectives) triggered by a given policy intervention (ideally, *ex ante*). Policy makers should manage these linkages over time proportionately to their observed effect (in the case of *ex-post* analysis) or expected impact (in the case of *ex-ante* analysis). This process should be integrated in and systematically followed during regular policy-making processes, based on the following six **I-SIP Propositions**:

1. **Clear definitions.** Clear definitions for each of the I-SIP objectives at the national level and at the level of specific policy interventions are needed to guide policy makers in policy design. The definitions at the policy intervention level should be detailed enough to allow for measuring the effects of the intervention with regard to I-SIP objectives.
2. **Structured approach.** A structured approach to identifying material linkages among I-SIP objectives that may arise in the implementation of a specific policy intervention helps to manage and optimize linkages, thereby avoiding false or unnecessary tradeoffs between objectives and maximizing synergies among them.
3. **Collaboration.** Inter- and intra-agency collaboration is critical to design, monitor, and adapt policy interventions to optimize the linkages among I-SIP objectives, as well as linkages with national objectives beyond the I-SIP objectives.
4. **Regular data.** Regularly collected and analyzed data based on indicators and targets specific to a given policy intervention enable the monitoring of its effects on the I-SIP objectives and the management of linkages over time.
5. **Consultation with providers.<sup>a</sup>** Periodic structured consultation with providers in proportion to the scale of the proposed policy changes helps to identify and manage linkages as the market develops.
6. **Policy adaptation.** Optimization of I-SIP linkages requires a commitment by policy makers to manage the I-SIP linkages by adapting policy and regulation as necessary in light of the data and other evidence collected and effects observed.

a. One form of such consultation is a so-called regulatory sandbox—a regulatory approach that allows for testing innovations in a controlled environment and can help supervisors understand innovations and foster responsible innovation in the market.

3 CGAP (2012) referred to the seven I-SIP propositions as “guidance statements”; these were later replaced with six “propositions.”

4 For more detailed information, see Staschen (2014b) and Staschen (2014a).

based access to and use of formal financial services promotes financial stability depends on how that access and use is managed within the regulatory and supervisory framework, especially in terms of financial integrity and consumer protection. These four factors: financial inclusion, stability, integrity, and consumer protection are inter-related and, under the right conditions, positively related. Yet, in many cases, failings on one dimension have been found to lead to problems on others.<sup>5</sup>

The I-SIP research study involved selecting policy interventions (cases) for analysis, collecting information about each of the selected cases through the analysis of available data, reviewing relevant secondary sources, interviewing relevant stakeholders, and synthesizing learnings from the cases, with an emphasis on identifying the observed effects of each of the cases on each of

the I-SIP objectives. Linkages among the I-SIP objectives were analyzed in pairs for each of the selected policy interventions, focusing on the linkages between financial inclusion and each of the other three objectives.<sup>6</sup> For each pair of linkages, there were nine possible outcomes as shown in Figure 1.

The I-SIP research exercises conducted so far have shown that both synergies and trade-offs among the I-SIP objectives are possible, highlighting both the challenge and the goal for policy makers to create policies that lead to outcomes falling in the green zones and avoiding the gray and red zones (or at least minimizing the tradeoffs and other negative outcomes). The I-SIP Approach and the I-SIP Propositions are intended to help achieve this goal.<sup>7</sup> Box 1 presents the definition of the I-SIP Approach, which incorporates the evolving thinking and insights from all four I-SIP research exercises.

**FIGURE 1. Possible pair-wise linkage zones: Financial inclusion and stability**

		Impact on financial inclusion		
		Negative	None	Positive
Impact on Financial Stability	Positive	Stability enhancing, inclusion reducing	Stability without effect on inclusion	Synergy
	None		Ineffective policy	Inclusion without effect on stability
	Negative	Lose-lose		Inclusion enhancing, stability reducing

5 See Cull, Demirgüç-Kunt, and Lyman (2012) and Sahay et al. (2015).

6 In contrast to a regulatory impact assessment focused on measuring impact, the I-SIP research attempts to explain the process of managing linkages and understanding how this can elucidate the observed effects.

7 The I-SIP Propositions were designed in the context of the I-SIP research. However, they function more broadly as essential components of effective policy making, including for objectives other than I-SIP (i.e., employment generation, competition, poverty alleviation, inequality reduction, and faster economic growth).

### 1.3 I-SIP Research Exercise in the Philippines

The Philippines is the fourth country in which an I-SIP research exercise has been conducted. The field interviews for this exercise were conducted in August 2015.<sup>8</sup> They followed a series of discussions between CGAP and BSP regarding experiences balancing I-SIP linkages in relevant Philippine policy making. The Philippines was chosen for the research because of its public commitment to financial inclusion and numerous policy interventions in support of this objective.

Specific goals for the Philippines I-SIP included the following:

- Contribute to further refinement of the research approach and conceptual deepening of understanding I-SIP linkages based on observed effects of select Philippine policy interventions.
- Contribute to further refinement of the I-SIP Approach overall and specific I-SIP Propositions (see Box 1) based on the Philippine experience.
- Raise awareness of I-SIP linkages among relevant Philippine regulators, supervisors, and policy makers, positioning them to better optimize the four policy objectives in their work.
- Help BSP and other relevant Philippine policy-making bodies to adopt the I-SIP Approach in future policy-making efforts.
- Develop insights for possible independent application of the I-SIP Approach by interested countries.

The I-SIP study in the Philippines focuses on five policy cases. Each case represents a policy intervention—a law

or regulation, either adopted (*ex-post*) or under development (*ex-ante*)—that was analyzed to elucidate I-SIP linkages and to generate lessons learned on how policy makers can perform their responsibilities in a structured way while keeping in mind the linkages. The cases analyzed are presented chronologically:

- Presidential Decree 717 on mandated agricultural credit (1975, as amended by Republic Act No. 10000 or the Agri-Agra Reform Credit Act of 2009).
- The National Strategy for Microfinance (1997) and related laws and regulations.
- BSP Circular 649: Guidelines governing the issuance of electronic money and the operations of electronic money issuers in the Philippines (2009).
- BSP Circular 694 allowing the establishment of microbanking offices (2010).
- BSP draft regulations on pawnshops (2015, *ex-ante* policy case).

The cases were selected based on the following criteria: (i) demonstration of a linkage is expected, i.e., an intervention with an expected positive effect on one of the I-SIP objectives could also be expected to have an observable effect (positive or negative) on one or more of the other I-SIP objectives; (ii) availability of relevant data and qualitative evidence to support the analysis; (iii) for the *ex-post* cases, passage of sufficient time from the intervention to consider observable effects; (iv) for the *ex-ante* case, potential for the analysis to be useful in an on-going policy-making process; and (v) relevance of the case to other countries and potential to contribute to the global learning agenda.

<sup>8</sup> See Annex 1 for a list of interviews.

For each case, the research team systematically sought to understand the following key questions:

- Did policy makers *identify* potential linkages between financial inclusion, financial stability, financial integrity, and financial consumer protection at the time of designing the intervention?
- What discussions and actions took place (if any) to measure and *manage* potential tradeoffs or synergies between the I-SIP objectives?
- What has been the observed effect of the intervention on the I-SIP objectives to date using supporting data? From the evidence, to what extent could the process be characterized as an attempt to *optimize* outcomes (i.e., minimize tradeoffs and other negative effects and maximize synergies)?
- How has the application of the *I-SIP Propositions* contributed to the achievement of optimal policy outcomes?

#### 1.4 This Report

The field research for this report was conducted by a joint team from CGAP and BSP in August 2015 and reflects the developments through February 2016. Section 2 of this report presents relevant information on the current state of financial inclusion and financial inclusion initiatives in the Philippines to put the analysis of the five policy cases examined in a broad context. Section 3 includes the analysis of the five policy initiatives through the lens of the I-SIP Approach. The report concludes with observations and lessons learned as a result of the Philippines I-SIP research that may be relevant for other countries as they work on advancing financial inclusion (Section 4).

## 2. STATE OF FINANCIAL INCLUSION IN THE PHILIPPINES

This section presents a brief history of financial inclusion interventions and background on the state of financial inclusion in the Philippines. This information is presented to put the analysis of the five policy cases examined using the I-SIP Approach into a broader context.

### 2.1 The Philippines' Commitment to Financial Inclusion

The Philippines has a long history of attempts to bring unserved and underserved segments of the population into the formal financial system. These attempts include, among others, government-directed credit programs initiated in the 1970s that had limited success (see Section 3.1). A turning point in this effort was the adoption of the National Strategy for Microfinance in 1997, which was spearheaded by the National Credit Council.<sup>9</sup> The National Strategy for Microfinance envisioned the creation of a viable and sustainable microfinance market that would help provide poor households, including microentrepreneurs, with greater access to microfinance products and services. Through the National Strategy for Microfinance, the government aimed to rationalize inefficient government credit programs, accorded the private sector a greater role in microfinance, supported market-based principles, and committed to the creation of a supportive and appropriate policy environment and institutional framework for the microfinance market. Several laws and statutes were passed, echoing and further

institutionalizing the principles of the National Strategy for Microfinance. These efforts resulted in an observed commercialization and professionalization of the microfinance industry in the country, represented by banks and microfinance institutions (MFIs)<sup>10</sup> (see Section 3.2).

In parallel to the developments of microfinance in the banking and nonbanking (financial cooperatives and MFIs) sectors, the National Credit Council together with the other regulators of financial services providers—Insurance Commission, BSP, Securities and Exchange Commission (SEC), and Cooperative Development Authority (CDA)—worked to establish a robust regulatory environment for microinsurance provision in the Philippines. A National Strategy and Regulatory Framework for Microinsurance was established in 2010 to pave the way for the increase in microinsurance coverage in the country.

In the past decade, BSP has championed financial inclusion efforts in the Philippines. Alongside its traditional role as a central monetary authority, BSP's corporate strategy emphasizes its commitment to promoting financial inclusion, financial education, and consumer protection. The BSP initiatives in microfinance, as part of the implementation of the National Strategy for Microfinance,<sup>11</sup> have naturally progressed to an advocacy for financial inclusion, with the ultimate objective of providing access to finance not just to microenterprises, but to every sector currently unserved

<sup>9</sup> The National Credit Council was established by a Presidential order and included members from selected government ministries and agencies, banking associations, cooperative federations and basic sector organizations. This Council is chaired by the Department of Finance. BSP is a member. For more details see: <http://www.gov.ph/1993/10/08/administrative-order-no-86-s-1993/>

<sup>10</sup> MFIs in the Philippines include banks, cooperatives and microfinance nongovernmental organizations.

<sup>11</sup> This influenced the inclusion of microfinance-specific provisions in the General Banking Law of 2000, providing an impetus for BSP to mainstream microfinance as a banking activity.

or underserved by the formal financial system. To coordinate and promote efforts toward the expanded objective of financial inclusion, BSP transformed its Microfinance Unit (established in 2002) into the Inclusive Finance Advocacy Staff in 2007. A Microfinance Committee (also established in 2002), which provided oversight on the program and activities of the Microfinance Unit, was reconstituted in 2012 as the Inclusive Finance Steering Committee headed by the BSP Governor. The Committee consists of BSP top managers and is supported by four interdepartmental working groups that are focused on implementing BSP's four financial inclusion agenda components: policy and regulation, financial education and consumer protection, data and measurement, and advocacy activities.

BSP's commitment to financial inclusion is globally renowned. In 2008, BSP became one of the founding members of the Alliance for Financial Inclusion, and in 2011, it signed the Maya Declaration.

BSP recognized that financial inclusion is an important element of inclusive growth that can be achieved only when multiple factors like macroeconomic stability, good governance, infrastructure, innovation, and other socioeconomic factors are at their optimum levels. In 2014, BSP spearheaded efforts to establish the National Strategy for Financial Inclusion. It prepared the initial draft of the National Strategy for Financial Inclusion and convened an interagency body comprising 13 government agencies that contributed to developing this strategy through a highly consultative process.<sup>12</sup>

The vision of the National Strategy for Financial Inclusion is to provide effective financial access to a wide range of financial services to all Filipinos. It defines what, why, and how financial inclusion can be pursued by the public and private sectors together by setting a framework for systematic collaboration. The National Strategy for Financial Inclusion contains strategic statements in BSP's four financial inclusion agenda components. In a way, the National Strategy for Financial Inclusion shares BSP's approach to financial inclusion, and calibrates it so that other stakeholders can use it to take on activities that promote financial inclusion and support inclusive growth.

The National Strategy for Financial Inclusion was officially launched in July 2015 in the presence of high-level government officials, Her Majesty Queen Máxima of the Netherlands, the United Nations Secretary-General's Advocate for Inclusive Finance for Development, and nearly a thousand public- and private-sector stakeholders. The launch generated increased interest from various stakeholders to participate in the Strategy implementation process.

## 2.2 Key Access and Usage Data

The Philippine financial system has become more inclusive over the years as evidenced by data on financial service access points and usage of financial services.<sup>13</sup> However, important gaps still remain, reflecting the challenges of an archipelago country comprising 7,107 islands with a population of more than 100.98 million people.<sup>14</sup>

<sup>12</sup> This interagency body has been recently institutionalized as the Financial Inclusion Steering Committee and tasked with overseeing the implementation of the National Strategy for Financial Inclusion by Executive Order No. 208, 02 June 2016.

<sup>13</sup> The first World Bank Findex study on use of financial services was conducted in 2011.

<sup>14</sup> Unless noted otherwise, all data in this section are provided by BSP. The population figure is the official count of the Philippine Statistics Authority (2015).

## Access

- The number of bank branches from 2014 to 2015 increased by 3.8 percent from 10,315 to 10,710, and the number of automated teller machines (ATMs) grew by 10.3 percent from 15,692 to 17,314 over the same period. According to International Monetary Fund (IMF) statistics, in 2014 there were 8.8 bank branches per 100,000 adults in the country, which puts the Philippines ahead of Cambodia, Myanmar, and Vietnam, but behind the other member countries of the Association of Southeast Asian Nations (ASEAN) (Table 1) and well behind developed economies, such as Japan and the United States—with 33.89 and 32.39 bank branches per 100,000 adults, respectively.
- The number of microbanking offices (MBOs) (Section 3.4), which are less costly than regular bank branches and which cater to the banking needs of underserved clients, has increased to 540 in 2015 compared to 517 in 2014. This increase is significant considering that some of these MBOs are now serving 66 municipalities that used to have no access to regular banking offices.
- Other financial services providers such as nonstock savings and loans associations, credit cooperatives, microfinance nongovernment organizations, pawnshops, other nonbank financial institutions, remittance agents, money changers, and foreign exchange dealers and e-money agents, are still important access points, especially where a banking presence is lacking.<sup>15</sup> In 2015, 398 out of 591 municipalities, or 67 percent of the municipalities without bank branches, had access to these other financial services providers. At the same time, there are still 193 municipalities (12 percent of the total number of 1,634 municipalities, and 33 percent of the municipalities without bank branches) that do not have formal financial services.
- Reflecting the country's reliance on remittances,<sup>16</sup> there are more money

**TABLE 1. Number of bank branches per 100,000 adults in ASEAN countries, 2014**

ASEAN member country	Number of bank branches per 100,000 adults
Brunei Darussalam	19.83
Indonesia	10.98
Malaysia	10.71
Singapore	9.37
<b>Philippines</b>	<b>8.80</b>
Cambodia	5.58
Vietnam	3.83
Myanmar	3.14
Lao People's Democratic Republic	2.67 (2013)

Source: IMF 2013–2014.

<sup>15</sup> See Annex 2 for definitions and a list of financial services access points.

<sup>16</sup> According to the World Bank, in 2014, remittances represented 10 percent of gross domestic product in the Philippines. See <http://data.worldbank.org/indicator/BX.TRF.PWKR.DT.GD.ZS>.

transfer operators than bank branches in the Philippines. In 2015, there were 15,538 money transfer operators comprised of 6,589 pawnshops with remittance business and 8,949 remittance agents and money changers offering remittance services. In addition, there are 23,781 stores or merchants accredited as e-money cash-in/cash-out agents.

### Usage

- Use of formal financial products and services has increased, as evidenced by the growth in the aggregate amount of bank deposits (8 percent) and loans (14 percent) from December 2014 to December 2015.
- The number of microdeposit accounts in banks with microfinance operations increased by 29 percent to 2.6 million in 2015 from 2 million accounts in 2014. The number of microdeposits likewise increased by 32 percent to PhP 5.2 billion (US\$110 million) in 2015 from PhP 4.0 billion (US\$83 million) the year before.
- In 2015, there were 9.4 million registered e-money wallets, of which 6.4 million were active (see Section 3.3 for a discussion on the definition of “active”). In comparison, in 2014 there were 10.9 million registered e-wallets, of which 6.9 million were active. The number of cash cards linked to e-money increased by 17 percent to 26 million in 2015 from 22.1 million in 2014.
- In 2014, 39 banks authorized to sell microinsurance products. These banks, together with other licensed microinsurance providers covered 29 million individuals in 2014 compared to 28 million in 2013.
- Compared to its peers, the country is behind in the use of bank accounts and savings, while it is slightly ahead in the use of formal credit (see Table 2), according to Findex (2014).
- The Philippines has high and growing levels of use of informal financial services. According to Findex (2014), the percentage of those who borrowed from family and friends in the past 12 months increased to 48.7 in 2014 from 39 in 2011. The Philippines also has one of the highest percentages of adults borrowing money from private informal lenders in the world. In 2014, 13.5 percent of Filipino adults reported sourcing credit from an informal lender, up from 12.7 percent in 2011. According to BSP, 7 out of 10 adults who have savings save at home rather than with a financial institution.

**TABLE 2. Usage of main financial services, 2014 (% adult population)**

Indicator	Philippines	East Asia and the Pacific	Lower middle-income countries
Financial institution account ownership	28.1	68.8	41.8
Borrowed from a financial institution in the past year	11.8	11.0	7.5
Saved at a financial institution in the past year	14.8	36.5	14.8

Source: Findex 2014.

- After bills payment (used by 72 percent of the population), remittances are the second most popular type of financial services (used by 63 percent of Filipinos). Among remittance users, 59 percent are recipients only and 18 percent are senders only; the rest (23 percent) both send and receive. Cash remittances from overseas Filipinos grew by 4 percent from 2014 to 2015.

### 2.3 Definition and Measurement of Financial Inclusion in the Philippines

In the Philippine National Strategy for Financial Inclusion launched in 2015, financial inclusion is defined as “a state wherein there is an effective access to a wide range of financial products and services by all.” “Effective access” encompasses four components: access

(presence and proximity of financial services providers), usage (adoption and patterns of use of different financial services), quality (consumer experience), and welfare (perceived consumer impact). “Range of financial products and services” refers to savings, credit, payments, insurance, remittances, and investments.

In 2015, BSP launched a National Baseline Survey on Financial Inclusion—the first nationally representative survey designed to measure financial inclusion of Filipino adults. It aims to provide a more accurate picture of financial inclusion in the Philippines in terms of the four components of effective access. The effort is part of the commitment to enhance the data and measurement capacities of BSP to make better-informed and evidence-based policies. BSP plans to conduct the same survey every two years.

### 3. ANALYSIS OF POLICY INTERVENTIONS

This section presents the analysis of the five policy interventions selected for the I-SIP research. The policy cases are presented chronologically using the following structure:

1. Description of the policy change.
2. Discussion of the linkages that were identified and managed.
3. Observed effects on I-SIP objectives.
4. Learnings about managing linkages and optimizing results through the lens of the I-SIP Propositions.

#### 3.1 Mandated Agricultural Credit

##### a. Policy change

In the 1960s and 1970s, the Philippine government implemented several measures designed to further promote the development of the agricultural sector—one of the main sources of income and employment for the Philippine population (Box 2).

These measures included a wide range of agricultural credit programs at subsidized interest rates. The programs were primarily funded by a low-cost rediscount facility for agricultural lending at BSP. In this context, Presidential Decree No. 717 was issued on 29 May 1975. It mandated banking institutions to allocate 25 percent of their loanable funds to agricultural credit (the Agri requirement), including at least 10 percent for credit to agrarian reform beneficiaries, namely “tillers, tenant-farmers, settlers, agricultural lessees, amortizing owners, owner-cultivators, farmers cooperatives and compact farms.”<sup>17</sup> (This is known as the Agra component, which benefits beneficiaries of the Philippine land reform [see Box 2]).<sup>18</sup> The loanable funds were to be calculated using only operations carried out after May 1975. The Decree also allowed two alternative compliance modes: investment in government securities issued to finance lending to agrarian reform beneficiaries, and a rediscounting facility with BSP of eligible paper covering agrarian reform credits.

#### BOX 2. Philippine land reform

A set of measures focused on land reform started with Republic Act No. 3844 of 1963 “Agricultural Land Reform Code,” amended by Republic Act No. 6389 of 1971 “Code of Agrarian Reforms of the Philippines,” which aimed to establish cooperative- and owner-cultivatorship and the economic family-size farm as the basis of Philippine agriculture and, consequently, “divert landlord capital in agriculture to industrial development.” In June 1988, a new framework was established through Republic Act No. 6657 “Comprehensive Agrarian Reform Law,” which set up the Comprehensive Agrarian Reform Program to plan and program the acquisition and distribution of all agricultural lands in the lapse of 10 years, later extended for another 10 years. The Act was amended in 2008 by Republic Act No. 9700 “Comprehensive Agrarian Reform Program Extension with Reforms,” which extended the deadline by five years.

<sup>17</sup> “Compact farmers” refers to farmers who have adjoining farms that operate as a single unit under one management, farm plan, and budget.

<sup>18</sup> Purposes of credit included acquisition of work animals, farm equipment and machinery, seeds, fertilizers, poultry, livestock, feeds, and similar items; land acquisition under the agrarian reform framework; construction or acquisition of facilities for production, processing, storage, or marketing; and merchandising of agricultural commodities.

After some studies showed negative consequences of the measures promoting agriculture development,<sup>19</sup> the government implemented reforms in the mid-1980s, including the following:

- Interest rates deregulation.
- Termination of the subsidized rediscounting and development financing functions of the central bank.
- Consolidation of agricultural credit programs into a comprehensive fund that would offer agricultural credit guarantees to banks.
- Termination of direct agricultural credit programs by nonfinancial government agencies.

However, these reforms did not lead to increased access to credit by small farmers, whereas credit to other sectors expanded, including through subsidized programs.<sup>20</sup> In this context, upon clamor from small farmers, in 1988 the government restored directed agricultural credit through “livelihood programs” aimed at creating employment opportunities.<sup>21</sup>

Increasing concerns from government, private, and nonprofit sectors about the lack of access to credit by the poor despite the resurgence of directed credit led to the establishment of the National Credit Council in 1993. The Council had a mandate to rationalize the implementation of directed credit programs and identify alternative mechanisms for expanding financial access to the poor. The Council

carried out several studies that showed the inefficiency and ineffectiveness of the subsidized credit programs,<sup>22</sup> including—most importantly—low outreach to and participation by the target beneficiaries and financial unsustainability due to high costs, large default rates, and inefficient program management. The results of these studies led to the formulation in 1997 of a new market-oriented approach to agricultural lending, illustrated in both the National Strategy for Microfinance (see Section 3.2) and the Agriculture and Fisheries Modernization Act. Financial-sector reforms were subsequently implemented, including (i) the adoption of market-based interest rates; (ii) the termination of subsidized agricultural credit programs; and (iii) the creation of the Agro-Industry Modernization Credit and Financing Program to provide wholesale credit to government financial institutions, which in turn would on-lend to retail lenders (e.g., rural banks, cooperative banks) to facilitate access to agricultural credit.

Despite waves of liberalization reforms in the 1980s and 1990s, Presidential Decree No. 717 and its mandated agricultural credit requirements for financial institutions remained. The only effect of such reforms on the Decree’s implementation occurred in 1994 through the enactment of Republic Act No. 7721 “Act Liberalizing the Entry and Scope of Operations of Foreign Banks in the Philippines and for Other Purposes” (RA 7721). RA 7721 expanded alternative compliance modes to any foreign bank’s majority-owned

19 Rural banks had low repayment rates and high default rates of subsidized credit programs. Many borrowers ended up being excluded from financial services. Commercial banks complied with the law primarily through investing in government securities because of the initially perceived high risk and then the observed high default rates of the sector, as well as an environment of controlled interest rates that further reduced incentives to invest in the provision of financial services in rural areas. See, for example, Esguerra (1981) and Lamberte and Lim (1987).

20 See Llanto (2005).

21 Cabinet Resolution No. 29 “Approving a Set of Policy Guidelines Governing Livelihood Programs and Projects,” approved 9 November 1988.

22 For summaries of the results of those studies, see e.g., Adams and Lim (1998); Llanto, Geron, and Tang (1999); and Geron and Casuga (2012).

subsidiary and any Philippine bank with 60 percent of voting stock held by a foreign bank, so as to include loans to educational institutions, cooperatives, hospitals and other medical services, socialized or low-cost housing, and local government units without national government guarantee.

In July 2009, Presidential Decree 717 was repealed and replaced by Republic Act No. 10000 “Act providing for an Agriculture and Agrarian Reform Credit and Financing System through Banking Institutions” (RA 10000). RA 10000 expanded the scope of the Agri requirement to include the fishing sector and specified that borrowers for agricultural and agrarian reform credit may include fishworkers and farmers’ and fisherfolks’ cooperatives, organizations, and associations in good standing. As with Presidential Decree 717, the Agri requirement remained at 25 percent of loanable funds, of which 10 percent shall be made available to agrarian reform beneficiaries; whereas the loanable funds were to be computed as net changes in specific financial statement accounts from the date the law was effective (20 April 2010) to the reporting date.<sup>23</sup> Further, RA 10000 indicated that the quota was subject to a joint review by the Department of Agriculture, the Department of Agrarian Reform, and BSP after three years of implementation, to determine whether the law has been effective in accomplishing its goals. This review is ongoing.

RA 10000 was an inflection point that introduced two key changes to the Agri-Agra framework: (i) entities would be subject to an annual penalty of 0.5 percent of the amount of noncompliance or under-compliance with the Act, to be allocated to the Agricultural Guarantee Fund Pool (45 percent), the Philippine

Crop Insurance Corporation (45 percent), and BSP (10 percent); and (ii) the range of alternative compliance modes was narrowed to only those that directly benefit the agriculture and agrarian reform sector, replacing the two modes included in Presidential Decree 717 and the additional ones added by subsequent regulations (e.g., RA 7721). The new alternative compliance modes, which were to be detailed by rules promulgated by BSP, the Department of Agriculture, and the Department of Agrarian Reform, included the following:

1. Investing in bonds issued by the Development Bank of the Philippines and the Land Bank of the Philippines (and declared as eligible alternative compliance by the Department of Agriculture in coordination with the Department of Agrarian Reform) and/or opening special deposit accounts with BSP-accredited rural financial institutions (e.g., thrift banks, cooperative banks, rural banks), as long as the funds received through these investments and/or deposits are used only for on-lending to the Agri-Agra sector, and are not counted as loanable funds for the aforementioned banks and rural financial institutions.
2. Rediscounting papers covering agriculture, fisheries, and agrarian reform credits with universal and commercial banks, provided that these papers are not eligible for compliance by the originating bank.
3. Lending for construction and upgrading of infrastructure, such as farm-to-market roads, post-harvest facilities, and other public infrastructure that is to benefit the Agri-Agra sector.

<sup>23</sup> See also Circular No. 736 of 2011, Rules and Regulations on the Mandatory Credit Allocation for Agriculture and Agrarian Reform Credit.

4. Investing directly in preferred shares of stock in accredited rural financial institutions (e.g., rural banks, cooperative banks, farmers' cooperatives, farmers' mutual benefit associations)<sup>24</sup> or lending wholesale to accredited rural financial institutions, provided that these institutions directly target Agri-Agra sectors, and that wholesale loans be credited as compliance of the wholesaler alone.
5. Investing in shares of stocks of the Philippine Crop Insurance Corporation and the Quedan and Rural Credit Guarantee Corporation.<sup>25</sup>
6. Loans and investments to Agri-Agra related activities enumerated under the Agriculture and Fisheries Modernization Act.<sup>26</sup>

BSP Circular No. 736 of 2011 revised the Agri-Agra rules and regulations to implement the provisions of RA 10000 that were applicable to the banking sector. The Circular further clarified the concept of direct compliance as lending to qualified borrowers for Agri-Agra credit (e.g., farmers, fisherfolk, agrarian reform beneficiaries, settlers, tenant farmers, farmworkers, farmers' and fisherfolks' cooperatives, organizations, and associations) for qualified purposes under Section 4 of RA 10000.

#### **b. Which linkages were identified and managed?**

The main objective of Presidential Decree 717 was to promote access to credit by agrarian reform beneficiaries, such as tenant-farmers, agricultural lessees, owner-cultivators, farmers' cooperatives, and compact farms, through government and private banking institutions. RA 10000 established a similar but slightly broader policy objective of "enhancing access of the rural agricultural sector to financial services and programs that increase market efficiency and promote modernization in the rural agricultural sector."<sup>27</sup> As of June 2014, the government had distributed land to about 5.5 million agrarian reform beneficiaries and had a remaining balance of about half a million beneficiaries.<sup>28</sup> These beneficiaries represent the target population that could benefit from the efforts of Presidential Decree 717 and RA 10000.

**Linkages between inclusion and stability.** One of the main objectives of the policy was closely linked to financial inclusion, which ideally is not at the expense of financial stability, in light of potential expansion and diversification of the customer base both at system and institutional levels. However, the potential positive effect on stability is impacted by the fact that the new customers are all

24 Accreditation is conducted by BSP for banks. The Agricultural Credit Policy Council, as authorized by the Department of Agriculture and the Department for Agrarian Reform, accredits other types of financial institutions that are not under BSP supervision.

25 The Quedan and Rural Credit Guarantee Corporation was a government financing institution created to establish a credit delivery system and a guarantee facility to promote inventory financing of commodities, production facilities and machineries, investment in inputs and labor, and the development of rural livelihood enterprise.

26 Agriculture and fisheries production (including processing of fisheries and agri-based products and farm inputs); acquisition of work animals and farm and fishery equipment and machinery; acquisition of seeds, fertilizer, livestock, and other similar items; procurement of agriculture and fisheries products for storage, trading, processing, and distribution; acquisition of water pumps and installation of tube wells for irrigation; construction, acquisition, and repair of facilities for production, processing, storage, transportation, and other support to agriculture and fisheries; working capital for agriculture and fisheries graduates to enable them to engage in agriculture and fisheries-related economic activities; agribusiness that supports soil and water conservation and ecology enhancement; irrigation systems for watershed protection; working capital for long-gestating projects; and credit guarantees on uncollateralized loans to farmers and fisherfolk.

27 Despite the broader policy objective, the focus has been on credit.

28 Land distribution under the Comprehensive Agrarian Reform Law (Congressional Policy and Budget Research Department 2015).

highly exposed to the risks associated with a single economic sector (agriculture and fisheries), and that this sector presents a high risk for the financial institutions implementing the inclusive measures—this being the case for universal and commercial banks in the Philippines with little, if any, expertise in lending to the agricultural sector.<sup>29</sup>

The agricultural sector has particular characteristics, for example, in terms of production and business cycles, cash flow, type of available collateral, sources of repayment risk (including frequent and devastating natural disasters), or customer profile, that differentiate it from traditional sectors targeted by universal and commercial banks. These banks require the implementation of appropriate techniques, tools, and methodologies to offer products tailored to the agricultural sector and to properly identify, administer, mitigate, and monitor credit risk, to avoid compromising their safety and soundness.

In terms of credit risk mitigation, the government set up two important mechanisms to help banks with the offering of agricultural loans and to address potential stability risks. The Philippine Crop Insurance Corporation was created in 1997 as a government-owned entity charged with offering insurance protection for rice, corn, high-value crops, aquaculture, livestock, and agri-fishery assets. Although the Corporation's core mandate was to provide fully subsidized insurance to marginalized farmers, it also developed insurance products with market-based premiums for other customer segments. The Corporation aims to provide financial institutions with credit risk mitigation measures that would allow them to provide further credit to the Agri-Agra sector. However, its low level of capitalization (linked to

its dependence on government funding) has remained a key constraint on its expansion, because financial institutions, especially commercial banks, consider it inadequate.

The other relevant credit risk mitigation mechanism is the Agricultural Guarantee Fund Pool, created in 2008 as a program under Land Bank to provide guarantees for unsecured agriculture-related loans (or the unsecured portion of a partially secured loan) to small farmers and fisherfolk against all types of risks except for fraud at the lending institution. The Pool covers 85 percent of the outstanding balance at the time of a claim. To participate in the program, banks must have a past due loan ratio below 15 percent, and financial cooperatives below 25 percent. (These high ceilings seem to illustrate lower consideration to the stability objective, which would require that past due loan ratios be much lower than 25 percent to participate in the program). The guarantee program fee is 2 percent per annum (with a 50 percent discount for agrarian reform beneficiaries). However, a limitation of the guarantee from the provider's perspective is that once a borrower has a repayment problem, the guarantee cannot be renewed after a partial (e.g., interest-only) payment; it has to be fully executed and then paid in full again.

**Linkages between inclusion and protection.** The Agri-Agra legal framework aims to minimize agricultural customers' engagement with informal financial providers—which do not follow any consumer protection standards—and to foster customers' integration into the formal financial sector (specifically the banking sector regulated and supervised by BSP, both from a prudential and a consumer protection standpoint). It also pays special attention to

<sup>29</sup> It is important to build capacity of providers given the risks of lending when there is a lack of expertise and knowledge.

a segment of vulnerable customers that is in particular need of minimum consumer protection standards, namely agrarian reform beneficiaries, which include a high percentage of low-income population segments. (Studies indicate that, although poverty incidence among agrarian reform beneficiaries has been declining, it still represents about a third of the population.)<sup>30</sup> BSP is in the process of implementing a comprehensive consumer protection regulatory and supervisory framework for financial institutions under its remit. However, it has already issued minimum consumer protection rules, including Circulars issued in 2011–2012 that updated and strengthened the implementation of the Truth in Lending Act through disclosure and transparency requirements applicable to all credit institutions. BSP also provides consumers with orientation and assistance to resolve their complaints against financial institutions—both would represent significant improvements in consumer protection for agriculture customers coming from the informal financial sector.

**Linkages between inclusion and integrity.** The Agri-Agra legal framework aimed to contribute to further financial integrity by increasing traceability of transactions made by agricultural customers who were previously transacting outside the formal financial system. However, there were practical challenges to achieve this goal. For example, know-your-customer (KYC) requirements made it harder for agricultural customers without formal IDs to open an account. Simplified requirements were introduced later, such as the reduction of minimum IDs from two to one and the acceptance of a higher

number of identification forms including, for example, letters from village chiefs that required a photo. However, several financial providers consider that current requirements are still too strict for the level of the money laundering and financing of terrorism risk associated with basic products, and they suggest that tiered KYC, for example, allowing remote account opening, would help to expand financial inclusion.

The absence of a comprehensive centralized government database of agrarian reform beneficiaries also complicates providers' efforts to efficiently identify customers. From a credit perspective, proof of land ownership is often required as collateral, but some agrarian reform beneficiaries (e.g., heirs of the original recipient of the land) cannot show appropriate proof (e.g., transfer title) and, thus, cannot have access to formal credit.

### c. What have been the observed effects so far on the I-SIP objectives?

**Inclusion.** In terms of the expansion of agricultural credit, the volume of outstanding loans from 2009 to 2014 has increased by 17 percent, led by increases of 15 percent in the universal and commercial banking segment and a remarkable 122 percent in the thrift banking segment. Despite these increases, thrift, universal, and commercial banks are having a hard time complying with Agri-Agra credit quotas (Table 3). The levels of total (direct and alternative) compliance with the Agra requirements are around 1 percent instead of the required 10 percent.<sup>31</sup> In 2013 and 2014, thrift banks did not meet Agri-Agra requirements.

30 In 2014, the Philippine Statistics Authority indicated that fishermen and farmers had posed the highest poverty incidences among the nine basic sectors of the Philippine economy in 2006, 2009, and 2012. See <https://psa.gov.ph/content/fishermen-farmers-and-children-remain-poorest-basic-sectors-0>.

31 Although Table 3 shows that rural banks have been complying with the Agri and Agra requirements at the industry level, some individual rural banks, especially those that are not based in agricultural areas, find it difficult to comply with such requirements.

**TABLE 3. Funds mobilized to comply with Agri-Agra requirements (percentage of total loanable funds), 2011–2014**

	2011	2012	2013	2014
<b>Funds mobilized to comply with Agra requirements (total of loans and alternate compliance)</b>	<b>4.77</b>	<b>2.08</b>	<b>1.38</b>	<b>1.46</b>
Universal and commercial banks	3.14	1.02	0.89	0.99
Thrift banks	7.32	4.93	1.49	1.71
Rural banks	37.86	28.49	24.53	18.47
<b>Funds mobilized to comply with Agri requirements (total of loans and alternate compliance)</b>	<b>32.35</b>	<b>21.71</b>	<b>15.56</b>	<b>15.21</b>
Universal and commercial banks	30.43	20.03	16.04	15.28
Thrift banks	37.81	34.14	6.76	8.62
Rural banks	67.29	52.30	44.59	34.21

Source: BSP.

All this information is based on supply-side data. There are some estimates on the demand of agricultural credit, but these estimates have raised concerns on the type of methodology used. In any case, there is a clear need for more in-depth studies on the following:

- Credit demand and credit needs from the agriculture sector.
- Whether the agricultural credit products offered by nonrural banks are properly tailored to that sector so that they can compete with credit offered by informal providers.
- Barriers to formal credit perceived by agricultural customers, so that policy measures can be reoriented toward addressing the root causes of any limitations in the offer of agricultural credit.
- The importance of credit shortage compared with other obstacles to agricultural-sector development, and the comparison of the gross value added of the agricultural sector with other economic sectors.

**Stability.** Persistent noncompliance with the Agra requirements and under-compliance with the direct component

of the Agri mandate by universal and commercial banks (and recently also by thrift banks) seem to indicate that such requirements do not correspond to the actual demand for credit and/or do not address the actual credit constraints and needs of the agricultural sector. Thus, banks are pushed to use their funds inefficiently and to make inadequate business decisions to either use alternative modes to comply with the law or pay the penalties. In fact, interviews with providers and regulators indicated that many banks consider the Agri-Agra requirements to be a form of tax and prefer to pay the penalties as part of their operational expenses, which has a direct effect in the financial performance and sustainability of providers. Further, the internalization of compliance costs in practice means that only 75 percent of funds would be available to non-Agri-Agra sectors. These costs could be directly or indirectly passed to these sectors (e.g., the interest rate for loans to customers from these sectors would have to be high enough to offset the costs associated with Agri-Agra compliance).

Although the creation of the Agriculture Guarantee Fund Pool was an important measure to mitigate agricultural credit risk, its impact has been limited (only

about half of the targeted funds have been allocated). As indicated by interviewees, one of the factors that may explain the limited use of the Pool is that providers seem to have limited confidence in it and see it more as part of the government bureaucracy than as an independently run service provider. The Pool has not been constituted as a separate legal entity or government corporation, and it is rather only a fund set up by the Department of Agriculture and managed by the Land Bank of the Philippines. The design of the guarantee also does not seem to correspond to the needs of financial institutions. For example, it may favor a guarantee instrument that provides temporary support for customer repayment problems rather than full extinction of customer obligations. Further, the Philippine Crop Insurance Corporation's role as a credit risk mitigation mechanism has been limited because of its low level of capitalization and consequent limited capacity to offer adequate insurance coverage only to a few providers.

Another source of stability risk is the potential impact of over-indebtedness of new financial consumers concentrated in an economic sector. The current absence of a comprehensive credit reporting system in the Philippines (see Section 3.2) or, at a minimum, centralized information on credit exposure of Agri-Agra customers can lead to over-indebtedness in this specific segment of new financial consumers.

**Integrity.** Agri-Agra requirements have allowed agrarian reform beneficiaries and other agriculture-sector borrowers to enter into the formal financial system. Their traceable transactions contribute to the financial sector integrity policy objective. At the same time, some efforts to expand financial inclusion to low-income and rural population segments have faced challenges regarding compliance

with KYC requirements that are perceived as too strict for the type of basic products offered to those segments.

**Protection.** On one hand, Agri-Agra customers who have entered into the formal financial sector can benefit from financial consumer protection rules applicable to the banking sector and can turn to BSP if they have complaints about their banks. On the other hand, there is potential risk of unsuitable products being offered to Agri-Agra customers, for the sake of reaching volume or number goals. This risk is exacerbated by problems with the list of beneficiaries of the Agrarian Reform. The list may include people who are not actual beneficiaries and may not include real beneficiaries. In addition, the absence of a comprehensive credit reporting system or a centralized database with credit information of the agrarian reform beneficiaries exposes this already vulnerable population segment to a higher risk of over-indebtedness. Moreover, there is no disaggregated information on complaints and inquiries by customer segments. This information would provide a richer understanding the types of issues agrarian reform beneficiaries and agricultural sector borrowers face.

The absence of credit history information and the limited effectiveness of credit risk mitigation mechanisms, such as the Agricultural Guarantee Fund Pool, are among the key factors behind high interest rates in the agricultural sector, which may also exacerbate the risk of over-indebtedness.<sup>32</sup>

#### **d. What have we learned about managing linkages and optimizing results?**

**Definitions.** The Agri-Agra framework follows an outdated vision of financial

32 According to Teves (2014), the highest interest rates on agricultural loans in the region are in the Philippines, where the average rate charged by formal lenders is 26.7 percent per annum, based on a study by the Agricultural Credit Policy Council (see <http://www.econ.upd.edu.ph/dp/index.php/dp/article/viewFile/1469/946>).

inclusion that is focuses only on increasing credit supply, without paying attention to the demand for credit, quality of credit products, or suite of financial services needed by the agricultural sector to improve customer welfare. Although these elements are already considered in the national strategies for microfinance and financial inclusion, they have been absent from the Agri-Agra framework throughout its 40 years of implementation. The vision underlying the Agri-Agra framework illustrates the limitations of narrow policies that look only at partial elements of financial inclusion without taking into account other dimensions and its relationship with other policy objectives, especially consumer protection and stability. Greater attention to the importance of promoting the National Financial Inclusion Strategy seems to provide a unique opportunity to review Agri-Agra under a more comprehensive definition of financial inclusion.

**Structured approach.** The Agri-Agra framework has had a narrow focus on credit expansion for the agricultural sector. Other measures have been developed in parallel to try to mitigate credit risk. However, no real consideration of the effects of Agri-Agra on the other policy objectives seems to have been made. BSP could improve the required reports on compliance with Agri-Agra to gather information that will help identify linkages between financial inclusion, stability, integrity, and consumer protection. Despite current data challenges, I-SIP linkages should be taken into account when evaluating the effectiveness of the Agri-Agra legal framework.

**Inter- and intra-agency collaboration.** An interagency body for the Agri-Agra framework comprises BSP, the Department of Agrarian Reform, and the Department of Agriculture. However, there still seem to be numerous information gaps among the different entities

engaged with Agri-Agra-related activities. From a practical standpoint, there is no centralized platform where multiple agencies can see and share information on beneficiaries of different agriculture credit policies in real time, which would help not only with the provision of those programs, but also with the evaluation of their effectiveness. Thus, coordination efforts should include actors such as the Philippine Crop Insurance Corporation, the Agricultural Guarantee Fund Pool, and the Credit Information Corporation. On a more general level, a significant and more structural revision of the Agri-Agra framework beyond what was done with RA 10000 may require a proactive multi-stakeholder effort to foster a national discussion on “data versus dogma” surrounding the agricultural sector, similar to what was done around the National Strategy for Microfinance (Section 3.2). This discussion would be particularly helpful to further identify the linkages between the Agri-Agra framework and the overall objectives of financial inclusion, stability, integrity, and consumer protection.

**Data.** The recently passed Republic Act No. 9510 “Credit Information System Act,” which establishes a national credit register, is an important step for financial services providers and government authorities to better understand and assess credit risks and gather more detailed data on credit access, use, and quality. The combination of credit register data and agricultural credit data generated by different agencies could provide rich inputs to studies on the effectiveness of various agricultural credit policies. However, there has been little effort to conduct such studies and other in-depth demand-side studies on the agricultural sector and its overall financial needs. Data analysis efforts would be key to support any meaningful revision to the Agri-Agra framework. Wider data gathering and analysis efforts are needed to assess

the effectiveness of current agricultural credit policies on credit provision (and indirectly on financial inclusion), to have a more comprehensive view of the persisting challenges to providing credit (and ultimately financial inclusion) in the agricultural sector from a demand-side perspective, and to better understand the effects of Agri-Agra on financial stability, integrity, and consumer protection.

**Consultations with providers.** All the banking associations in the Philippines would benefit from concerted efforts to produce and share detailed information on credit demand and needs and obstacles faced by different segments.<sup>33</sup> These efforts could shed light on financial inclusion challenges (particularly access to credit challenges) of agriculture customers, observed effects on their business, product, and efficiency costs, as well as safety and soundness indicators.

**Policy adaptation.** The small number of revisions of the Agri-Agra framework since the issuance of Presidential Decree 717 of 1975 may indicate the challenges of adapting directed credit laws to take into account changes in financial-sector policies triggered by both financial-sector developments as well as identification of new linkages with other financial-sector objectives. The main changes to the agricultural credit framework implemented through RA 10000 had a much narrower reach than parallel changes observed in the microfinance framework implemented through the National Strategy for Microfinance (see Section 3.2). The particular complexities of agricultural credit policies from economic, social, and political standpoints require policy makers to monitor their results much more closely and to revise policies if they are not effectively addressing agricultural-sector problems, or if they worsen problems or create new problems.

### 3.2 National Strategy for Microfinance

#### a. The policy change

Even though it took place almost 20 years ago, the process of elaborating the National Strategy for Microfinance, its principles, and its outcomes are well-known to the financial inclusion community in the Philippines. With a stated objective of better inclusion and improved stability, it can be considered a global best practice case in the way it supports some of the I-SIP propositions as described later in the report.

Prepared by the National Credit Council, which was established in late 1993 (see Section 2.1), the National Strategy for Microfinance was issued in 1997. The main stated objective of the National Strategy for Microfinance was “to provide access to financial services to the majority of poor households and microenterprises by the year 2005. This will be achieved in a liberalized and market-oriented economy where the private sector plays a major role and the government provides the enabling environment for the efficient functioning of markets and the participation of the private sector.”

The four key principles of the National Strategy for Microfinance were as follows:

1. Greater role of the private sector/ MFIs in providing financial services.
2. Enabling policy environment that will facilitate the increased participation of the private sector in microfinance.
3. Market-oriented financial and credit policies, e.g., market-oriented interest rates on loans and deposits.
4. Nonparticipation of government line agencies in implementing credit/guarantee programs.

<sup>33</sup> The Bankers Association of the Philippines, the Chamber of Thrift Banks, the Rural Bankers Association of the Philippines, and the Cooperative Bank Federation of the Philippines.

A key intention of the National Strategy for Microfinance was to stop inefficient, subsidized, government-directed credit programs. These programs were notorious for not reaching their objectives. A report by the National Credit Council prepared right before the issuance of the National Strategy for Microfinance assessed 86 of these credit programs and found that only a small number of people had benefited from them.<sup>34</sup> Getting state organizations' funds to be managed by financial institutions and channeled through the promising emerging private microfinance sector was seen as the best compromise.

The key principles of the National Strategy for Microfinance were diligently incorporated into laws. For example, two important laws integrated market principles for credit: the 1997 Social Reform and Poverty Alleviation Act and the 1997 Agriculture and Fisheries Modernization Act.<sup>35</sup> Executive Order 138 of 1999 carved in stone the objective of market-based financial and credit policies.

The General Banking Act of 2000 is another law aligned with the National Strategy for Microfinance. It recognized microfinance as a mainstream activity in the banking sector. Since then, BSP has issued more than 40 regulations, creating a policy environment aimed at enabling banks to provide microfinance services to microentrepreneurs and

low-income households in a safe, sound, and sustainable manner.

The response from banks was positive. Within a year from the issuance of the first microfinance circular (Circular 272) in 2001, about 119 banks were extending microcredit worth PhP 2.6 billion (US\$54.7 million) to 390,635 borrowers. At year-end 2015, there were 170 banks competing with microfinance nongovernmental organizations (NGOs) and credit cooperatives in the microfinance market. These banks serve 1.47 million clients with loans worth PhP 11.3 billion (US\$236.7 million). Many of these banks expanded the range of microloans to include housing microfinance, micro-agri loans, and higher loan values for growing microenterprises. Banks are now providing other microfinance services like microdeposits, microinsurance, and low-value payments and remittances. The banks have also explored the use of mobile technology through electronic money in serving their microfinance clients. These innovations in products and delivery channels were enabled by BSP policies and regulations.

Three types of MFI classifications emerged out of this strategy: microfinance-engaged banks<sup>36</sup> and microfinance-oriented banks supervised by BSP;<sup>37</sup> NGO MFIs registered with and supervised by the SEC; and cooperative MFIs supervised under CDA.<sup>38</sup>

34 Directed Credit Program Issues and Framework for Reform, NCC, 1997 ([http://pdf.usaid.gov/pdf\\_docs/Pnadi976.pdf](http://pdf.usaid.gov/pdf_docs/Pnadi976.pdf)).

35 The National Credit Council (through the Department of Finance as its chair and secretariat) participated in congressional deliberations in the passage of these laws to ensure that the principles of the National Strategy for Microfinance were incorporated into the provisions.

36 BSP categorizes banks as microfinance-engaged if less than 50 percent of their loan portfolio is in microfinance, defined as short-term loans under PhP 150,000 (US\$3,154) for entrepreneurial households.

37 Banks devoting over 50 percent of their loan portfolio to microfinance are categorized as microfinance-oriented.

38 According to the Regulatory Framework for Microfinance in the Philippines, there are three types of MFIs. (1) Banks with microfinance operations are supervised by BSP. They are registered with SEC as stock corporations and licensed as either a thrift or rural bank by BSP. They can take public deposits and undertake other banking activities as authorized by BSP. (2) Cooperatives with credit and savings operations are registered and regulated by CDA. Cooperatives are owned and governed by members, and can provide services only to members. (3) Microfinance NGOs are registered with SEC as nonstock, nonprofit entities, and can provide only credit services (and auxiliary services like capacity building) to program participants. They may collect savings (also called capital build-up or compensating balance) from microfinance clients as part of their loan methodology, but the clients and the NGO, respectively, must remain net borrowers and a net lender at all times.

## b. Which linkages were identified and managed?

The National Strategy for Microfinance emphasized early on the need to expand financial services to low-income customers. There are many links, however, between this stated objective and the other I-SIP policy objectives.

**Linkages between inclusion and stability.** Two of the four National Strategy for Microfinance objectives were directly related to stability by improving sustainability and efficiency in the financial sector: principles 3 and 4 suggested that greater financial inclusion could be achieved by strong, nonsubsidized, private-sector financial institutions.<sup>39</sup> In addition, amendments to the General Banking Law of 2000 provided a legal definition of microfinance activities,<sup>40</sup> allowing banks to carry out such activities, and created new types of microfinance-engaged and microfinance-oriented banks under BSP supervision. These changes allowed for flexibility of prudential supervision given the characteristics of microfinance—an example of an attempt at a proportionate approach by BSP. In 2001, BSP issued Circular 272,<sup>41</sup> which exempts microfinance loans from cumbersome regulations for unsecured loans under Section 41 of the General Banking Law. BSP also issued regulations that liberalized establishment and branching requirements for microfinance-oriented banks, which

enabled the transformation of NGOs into banks, and Circular 409 of October 2003, which requires the measurement of portfolio at risk and its corresponding provisioning.

The Regulatory Framework for Microfinance Institutions approved by the National Credit Council in July 2002 is a key document that illustrates the link between different I-SIP policy objectives. It included three objectives—two of which closely refer to stability: (i) to protect the financial system from unsound (i.e., excessively risky) practices by deposit-taking institutions (either from the public or its members) and thereby, protect the country's payments system and (ii) to promote the establishment of an accurate, reliable, and transparent set of financial information for all types of MFIs. The Regulatory Framework indicates that that NGO MFIs are not supposed to take deposits from their clients, so they are exempt from prudential regulations. This means that NGO MFIs that collect compulsory savings as an integral part of their microfinance methodology cannot go beyond the “compensating balance” (i.e., case wherein clients' outstanding loan is less than their compulsory savings).

To add specificities to the regulatory framework, a technical working group comprising the National Credit Council and other stakeholders developed performance standards for all institutions

39 The National Credit Council study on directed credit programs showed that these programs had limited reach and dismally low repayment rates. The implementation costs were enormous and a strain on public funds. The interest rates were subsidized, thus these programs were seen as “intervening” with the credit market. And government agencies overseeing the programs lacked capacity to monitor and evaluate impact.

40 Republic Act 8791, 23 May 2000.

41 BSP Circular 272 defines microfinance as loans to poor, low-income households and microentrepreneurs with maximum principal amount of PHP 150,000 (US\$3,154), granted on the basis of the borrower's cash flow, typically unsecured, amortized over the short term, with a market-based interest rate. Microfinance borrowers are exempt from providing documents (financial statements, income tax returns) typically required from regular borrowers, provided that the bank has well-defined policies, standards, and risk management mechanisms in place. Circular 272 says: “In view of the unique characteristics of microfinance loans, i.e., small unsecured and based on cash flow of borrowers, these loans may be exempted from rules and regulations which may be issued by the Monetary Board with respect to unsecured loans under Section 41 of the General Banking Law of 2000.” Article 41 of the Banking Law says: “Unsecured Loans or Other Credit Accommodations—The Monetary Board is hereby authorized to issue such regulations as it may deem necessary with respect to unsecured loans or other credit accommodations that may be granted by banks.”

engaged in microfinance. The rating system that was developed is called PESO, which stands for Portfolio quality, Efficiency, Sustainability, and Outreach. At the same time, the emergence of the Microfinance Council of the Philippines (MCPI) in the late 1990s enabled a variety of MFIs to develop standards for the microfinance industry.<sup>42</sup> MCPI membership includes 47 microlenders, and it claims to represent 75 percent of the total microfinance outreach in the country.

**Linkages between inclusion and integrity.** AML/CFT was not contemplated at the time the National Strategy for Microfinance was formulated, and the Strategy has not been revised because its principles remained relevant. While there are no data available besides the 1997 National Credit Council report, there is likely a significant positive link between inclusion and integrity because the National Strategy for Microfinance enabled the entry of formal financial institutions, thus promoting market efficiency, and enabled low-income customers to enter the formal financial sector and go through KYC as they became customers of microfinance-engaged and microfinance-oriented banks.

On a less positive note, neither NGO MFIs nor MFI cooperatives had to comply with AML/CFT regulations.<sup>43</sup> In theory, it would be possible to set up a credit NGO to channel funds of illicit origins. This risk is further exacerbated by weaknesses in the supervisory capacity

of SEC, which does not have a reliable registry of those NGOs that are involved in microfinance activities. Lastly, the KYC process may have slowed down financial inclusion, because KYC requirements are rather strict and costly given the absence of the national ID system in the country.

**Linkages between inclusion and protection.** The notion of consumer protection was not emphasized in the original Strategy document. In fact, a lot of the efforts on consumer protection from MCPI and BSP appeared much later, with the launch of the global Smart Campaign and its Client Protection Principles in 2007–2008<sup>44</sup> and the general market conduct regulations (including truth-in-lending rules) issued by BSP. MCPI has adopted the PESO standards for its members and started pushing them to record portfolio-at-risk and progressively endorse the Client Protection Principles. BSP's Circular 409 requirement for all banks with microfinance operations to show their portfolio-at-risk at one day was initially criticized by some industry players but is now seen as a positive evolution for the market. The National Confederation of Cooperatives, one of the largest federations of cooperatives with a network of over 660 cooperatives,<sup>45</sup> signed the Client Protection Principles in 2012.

However, a key intention of the National Strategy for Microfinance was to promote more competition in the market, which progressively enabled low-income

42 Registered with SEC in 1999, and originated by a USAID project, MCPI is the national network of MFIs working toward sustainable, innovative, and client-responsive solutions to poverty in the country. MCPI currently comprises 57 institutions, including 47 practitioners and 10 support institutions. Its regular members include 26 NGOs, 13 banks, 6 cooperatives, and 2 regional networks. See <http://www.microfinancecouncil.org/about-mcpi>.

43 Philippine laws on AML/CFT specify covered entities as those under supervision of BSP, SEC, the Insurance Commission, the Land Registration Authority, and the Registry of Deeds. Since microfinance NGOs are under SEC, they can be considered covered entities. Enforcement issues arise due to SEC capacity. The SEC regulatory framework for microfinance NGOs is currently being developed, as mandated under a recent law, the Microfinance NGO Act (2015). Cooperatives and CDA are, unfortunately, not specified as covered entities under the laws. However, CDA participates in one of the working groups of the ongoing National Risk Assessment in the Philippines.

44 The Smart Campaign is a global campaign committed to embedding client protection practices into the institutional culture and operations of the microfinance industry. See <http://www.smartcampaign.org/>.

45 This represents a significant portion of the financial cooperatives, though not all of them.

customers to access credit at lower costs (from 5 to 2 percent per month in the past 20 years) as compared to informal markets (about 20 percent). The 2002 Regulatory Framework for Microfinance also has one key objective related to protecting customers: “To protect small clients.”

BSP Memorandum No. 2008-020 dated 14 May 2008 reiterated the requirement that all its supervised institutions be transparent about loan collection practices in line with the Truth in Lending Act (TILA) of 1963.

A recent major turning point are BSP Circulars issued in 2011–2012, which update and strengthen implementation of TILA, requiring more transparency from all financial institutions engaged in lending and display of interest rates and fees on loan contracts.<sup>46</sup> Of particular interest are the following:

- Circular 730, which provides enhanced rules to implement TILA to improve transparency in loan transactions of all banks.
- Circular 754, which provides enhanced rules to implement TILA to improve transparency in loan transactions of all nonbank financial institutions under BSP supervision.
- Circular 755, which requires all credit granting entities outside BSP jurisdiction (e.g., microfinance NGOs) to display on their loan documents and marketing materials the following minimum information: total amount to be financed, all types of charges incident to the extension

of credit, net proceeds of the loan, and effective interest rate.<sup>47</sup>

These regulations are considered in line with global good practices. While TILA mandates BSP to prescribe the rules and regulations to carry out its provisions, it remains silent as to enforcement. BSP thus reached out to other relevant regulators such as SEC, the Insurance Commission, and CDA to issue similar rules to cover other nonbank actors.<sup>48</sup>

### c. What have been the observed effects so far on the I-SIP objectives?

**Inclusion.** With the new regulatory framework for microfinance, many banks, NGOs, and cooperatives started developing commercial microfinance activities. The effect of the National Strategy for Microfinance on inclusion is difficult to assess because of data constraints, but most interviewees see the strategy as a major “paradigm shift.” All in all, this was the starting point for what became a regional success story, with banks now serving over 1.47 million microfinance customers compared with fewer than 400,000 in 2002 (Figure 2) and microfinance NGOs serving close to 2.5 million customers with about 10 market leaders making up 80 percent of the market, as represented by industry leaders during interviews.

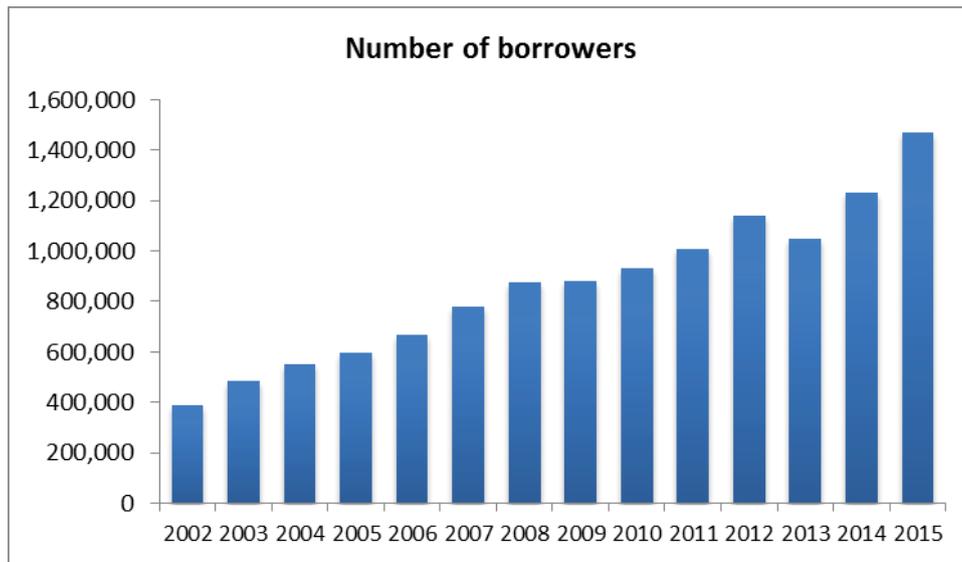
Map 1 shows that 106 MFIs cover all the provinces, all the cities, and 71 percent of towns. The industry leader, CARD Banking Group, is internationally recognized for its accomplishments

46 BSP Circulars 730 (covering banks) and 754 (covering nonbanks under BSP jurisdiction) mandate the computation of interest rates using the declining balance method and the use of a uniform disclosure formats.

47 <http://www.bsp.gov.ph/downloads/regulations/attachments/2012/c755.pdf>.

48 SEC issued its Memorandum Circular No. 7 dated 15 September 2011, which covered all lending and financing companies. The Insurance Commission issued Circular Letter No 31-2011 dated 5 October 2011 covering all insurance and reinsurance companies and mutual benefit associations. CDA mandated all credit and multipurpose cooperatives with savings and loan services to comply with TILA through Memorandum Circular No. 2012-05 Series dated 14 March 2012.

**FIGURE 2.** Number of microfinance borrowers from banks, 2002–2015



Source: BSP.

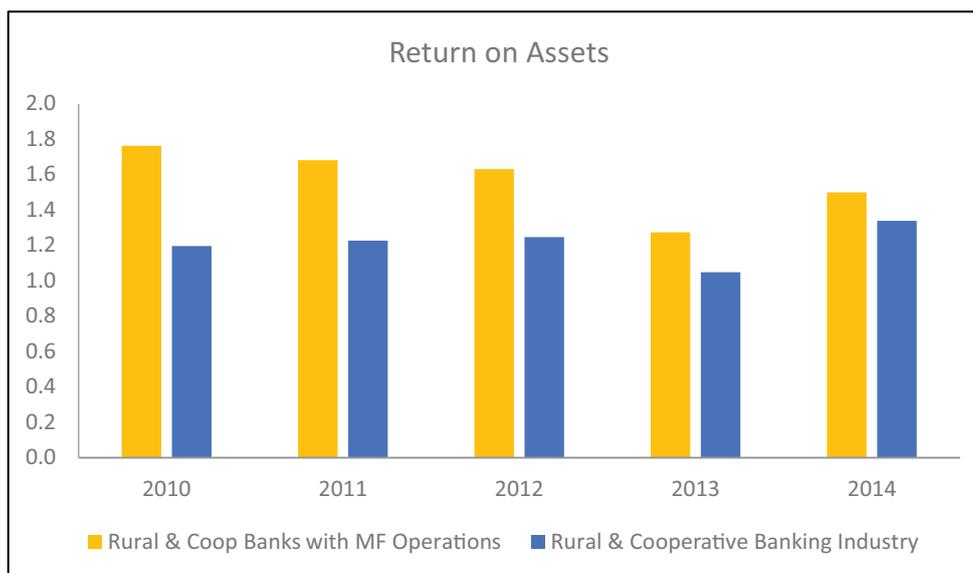
**Map 1.** Distribution of microfinance service providers in the Philippines—borrowers/partners of People’s Credit and Finance Corporation



in reaching low-income women with diverse financial services. A respected microfinance practitioner claims that the fact that more women (38 percent) than men (24 percent) have an account may be the result of the success of microfinance in the country.

The fact that almost 12 percent of adults borrowed from a financial institution in 2014 (higher than the average for East Asia and the Pacific and the lower middle-income countries as discussed in Section 2.2) could be a result of the development of microcredit.

**Stability.** The strategy’s focus on a market-based approach, sustainability, and viability (as translated in the General Banking Law) underpinned the approach of BSP in ensuring that microfinance was to be provided in the banking sector as a safe, sound, and sustainable undertaking. The National Strategy for Microfinance, the associated Microfinance Regulatory Framework, and BSP microfinance regulations encouraged banks to start engaging in the microfinance sector and enabled the

**FIGURE 3. Return on assets for rural and cooperative banks, 2010–2014**

Source: BSP.

creation of microfinance banks and the transformation of NGOs into banks.<sup>49</sup> As a result, a major part of the microfinance sector that had been unregulated became prudentially regulated and supervised. BSP data show that rural and cooperative banks that are engaged in microfinance have been more profitable compared to their peers that do not have microfinance operations (see Figure 3).

The National Strategy for Microfinance did not fully address the prudential regulation and supervision of nonbank MFIs. Indeed, large (and small) deposit-taking NGOs<sup>50</sup> and cooperative MFIs are not prudentially regulated or supervised because they do not fall under BSP's authority. Neither SEC (in charge of NGO MFIs) nor CDA (in charge of cooperative MFIs) has the staff and the technical capacity to supervise nonbank

organizations that receive funds from their members or clients, or to gather adequate information about its supervised sectors. In spite of its efforts to collect information on NGO MFIs, SEC has not managed to obtain this information systematically (although BSP estimates indicate that NGO MFIs served 2.5 million customers in 2014).<sup>51, 52</sup> Different kinds of MFIs undertaking similar activities are not uniformly supervised, which could put the stability of the sector at risk because the requirement that NGO MFIs' clients must be net borrowers and no prudential standards apply to them is not enforced. This type of situation leads not only to a lack of information on the overall sector but also creates possible opportunities for regulatory arbitrage. CDA indicates that there could be between 7,000 and 20,000 cooperatives engaged in lending operations. Some

49 In these transformations, NGOs acted as founders of new banks. See Lauer (2008).

50 These MFIs are not officially seen as deposit-taking MFIs because they are required to keep less deposits from clients than what these clients owe the MFI (their outstanding loan balance).

51 SEC plans to develop a company registration system that would enable the creation of a database on NGO MFIs.

52 Based on a BSP survey of 17 microfinance NGOs in 2013 and 16 microfinance NGOs in 2014.

interviewees expect that portfolio at risk over 30 days for financial cooperatives could be close to 30 percent, which is significantly higher than international standards. Fortunately there has not been any known significant incident of cooperatives' insolvency.<sup>53</sup> The context also provides opportunities for regulatory arbitrage where a bank could create an NGO or a cooperative to take advantage of the low level of regulation and supervision and the more relaxed taxation regime for NGOs and for cooperatives compared with that for banks. This happened on several occasions according to some interviewees but was addressed by BSP Circular 725 of 16 June 2011, which specified that a bank-NGO relationship must be at arms-length and transparent.

The recently approved Microfinance NGOs Act<sup>54</sup> calls for a Microfinance NGO Regulatory Council to be established by SEC. This Council will serve as an accrediting body, and its functions will include monitoring the performance of microfinance NGOs, requiring reports to be submitted regularly, and so forth.

**Integrity.** Although the team found limited evidence on this, it is likely that some “fly by night” NGO MFIs were created to raise funds from donors or customers and then disappeared with the funding. The initially high KYC requirements for new customers of bank MFIs may not have supported rapid expansion of financial inclusion, but their progressive relaxation has allowed the increase in the number of new clients, though challenges still remain as discussed earlier.

**Protection.** Besides providing extensive directions for implementing TILA in the banking sector, BSP has also become recognized as a major international

player in protecting customers with the introduction of a specific department in charge of customer protection and financial literacy as early as 2006. However, this department is not responsible for NGO or cooperative MFIs, because these entities are not under BSP regulation. Consequently, it is difficult to enforce the requirement that NGO MFIs and cooperatives display their interest rates and fees transparently. Similarly, both regulators have very limited capacity to respond to consumer complaints against NGO and cooperative MFIs.

The Philippines did not succeed in creating systematic credit information sharing. Indeed, the operationalization of a Credit Information Corporation under SEC has been slow. The law was passed in 2008, but actual implementation began in 2014. Faced with multiple borrowing and potential over-indebtedness risks, in 2012, some NGO MFIs voluntarily decided to create their own credit bureau system, the Microfinance Data Sharing System (MiDAS), which requires only eight data elements as opposed to the 129 required by the Credit Information Corporation and thus may be better suited for capacities of smaller MFIs.<sup>55</sup> Although the degree of over-indebtedness is difficult to estimate, multiple borrowing seems widespread, and there is general agreement in the industry that lack of credit information and increased competition have already saturated some markets. On the positive side, according to interviewees, the interest rate of MFIs on credit declined from 5 percent per month to about 2–3 percent per month in the past 20 years, which is in any case much better than the 20 percent monthly rate of informal money lenders.

<sup>53</sup> There is a dearth of data on insolvency cases in the cooperative sector.

<sup>54</sup> <http://www.gov.ph/2015/11/03/republic-act-no-10693/>

<sup>55</sup> There is at least one other credit bureau, the Bankers Association of the Philippines Credit Bureau (active since 1990), but it is voluntary and mostly deals with high-value transactions. MiDAS uses the database platform of the Bankers Association of the Philippines Credit Bureau.

#### d. What have we learned about managing linkages and optimizing results?

**Definitions.** The National Strategy for Microfinance played a significant role in defining a new field of finance. It formalized the notion of microfinance as a private-sector-led segment of the financial sector serving low-income population segments. At that time, however, the notions of financial consumer protection and AML/CFT did not stand out as policy goals so they were not formally woven into the National Strategy for Microfinance. The subsequent work on the National Strategy for Microinsurance (2010) and the National Strategy for Financial Inclusion (2015) provided an opportunity to amend the definitions of the I-SIP objectives.

**Structured approach.** The process of elaboration of the National Strategy for Microfinance became a standard process for policy making in the country. In a way, the National Strategy for Microfinance was the first strategy of its kind in the Philippines. It was such a success that it institutionalized the path for similar financial-sector reform agendas. For example, the subsequent National Strategy for Microinsurance of January 2010 and the more recent National Strategy for Financial Inclusion approved in July 2015 were designed using the same process as the National Strategy for Microfinance. The National Strategy for Microinsurance stated: “Consistent with the vision and key strategies espoused in the Strategy that was issued in 1997, the National Strategy for Microinsurance defines the objective, the roles of the various stakeholders and the key strategies to be pursued in enhancing access to insurance by the poor.”<sup>56</sup>

**Inter- and intra-agency collaboration.** Many interviewees highlighted the critical role of the National Credit Council

in elaborating the National Strategy for Microfinance. The intensive level of multi-stakeholder consultation within the National Credit Council was crucial in bringing different agencies together around a common vision and sets of objectives. The Council included diverse government bodies that have different views and perspectives, yet it was still able to converge on a shared objective and policy direction. At the same time, more collaboration with a broader range of stakeholders would have been useful—for example, on consumer protection and AML/CFT.

While this is not the case in all countries, in the Philippines, the role of donors such as the U.S. Agency for International Development (USAID) has been crucial in supporting the National Credit Council and BSP in elaborating the National Strategy for Microfinance and in supporting the industry overall. This intervention could be seen as a global good practice from an aid effectiveness perspective. By taking a “market” approach, USAID supported the articulation of different policy objectives by promoting stability and transparency (e.g., support to MCPI and to the elaboration of credit information sharing).

**Data.** One interviewee eloquently highlighted that the success of the policy reform of the National Strategy for Microfinance was linked to a “data versus dogma” approach, where a team of the National Credit Council technicians meticulously reviewed all the directed credit programs and highlighted the poor impact of these programs to justify the reform. The new National Strategy for Financial Inclusion is also based on significant data gathering.<sup>57</sup> The National Strategy for Microfinance and the associated Regulatory Framework and Performance Standards for MFIs,

56 <http://www.rbapmabs.org/blog/wp-content/uploads/2010/02/Philippine-Microinsurance-National-Strategy.pdf>

57 <http://www.bsp.gov.ph/downloads/publications/2015/PhilippinesNSFIBooklet.pdf>

however, lacked clear provisions on continuous and coordinated data gathering by concerned regulators, hence the current limited and fragmented data on the entire microfinance sector.

**Consultation with providers.** Throughout the development and implementation of the National Strategy for Microfinance, policy makers have been consulting with financial services providers and industry associations, such as MCPI, the National Confederation of Cooperatives, and the rural banking industry.<sup>58</sup>

**Policy adaptation.** The National Strategy for Microfinance is an example of a continuous and evolving policy adaptation process as evidenced by multiple laws and regulations adopted and under discussion that aim to build on the core principles supported by the Strategy. Taking into account the subsequent work on the National Strategy for Microinsurance (2010) and the National Strategy for Financial Inclusion (2015), the National Strategy for Microfinance could have been adjusted to incorporate work on financial consumer protection and AML/CFT.

### 3.3 Electronic Money Guidelines

#### a. The policy change

In December 2000, Smart Communications, the country's biggest telecom company, launched Smart Money, in partnership with MasterCard and Banco de Oro, one of the largest commercial banks in the Philippines. The service comprises a reloadable payment card linked to a Smart SIM card and enables Banco de Oro customers

to use their mobile phone to send and receive remittances domestically and internationally, buy airtime, receive salaries, repay loans, and pay bills. Smart Money customers can also pay for goods and services using the payment card.

In 2004, Globe Telecom, the second largest telecom in the Philippines, launched GCash. This service began with text-payment, deposit, and withdrawal functionalities, then expanded services in 2007 to include international remittances. Within a few years,<sup>59</sup> GCash offered a suite of financial services as varied as Smart Money's to Globe SIM holders via SMS without the need for a payment card (GSMA 2009). The two e-money services are not interoperable but, at the GSM Association (GSMA) Mobile World Congress in February 2015, they announced that their e-money operations would become interoperable within a year.<sup>60</sup>

When Smart Money was first introduced, it was a bank product of Banco de Oro, with Smart providing the platform infrastructure. This innovation did not raise concerns with BSP because BSP supervised Banco de Oro as a universal bank, with Banco de Oro outsourcing the service to Smart. However, Globe's decision to create a wholly owned subsidiary, G-Xchange, Inc. (GXI), to offer GCash presented a new challenge to BSP. GXI was established as a nonbank payments provider, outside BSP's supervisory authority. Initially, BSP considered GCash to be a money transfer service and required GXI to register as a remittance agent and be regulated and supervised as such. After allowing GCash to be pilot-tested for several years, BSP

58 Other stakeholders with whom consultations took place include the Alliance of Philippine Partners in Enterprise Development, the Coalition for Microfinance Standards, which later transformed into MCPI, and the Rural Bankers' Association of the Philippines.

59 GCash increased cash-in/ cash-out outlets in 2008; introduced domestic remittance, bills payment, and load in 2009; started payroll in 2010, card issuance and American Express in 2012, and MasterCard in 2013; and acquired open loop in 2014.

60 <http://business.inquirer.net/207626/paymaya-gcash-announce-successful-trials-of-mobile-money-interoperability>. As of February 2016, Smart Money and GCash were not interoperable.

developed a better understanding of the business, with its attendant operating models and risks, and issued Circular 649 on 9 March 2009.

Circular 649 defined e-money as electronically stored monetary value, withdrawable in cash, issued in the amount equivalent to the cash received, and accepted as payment for goods and services by participating merchants.<sup>61</sup> E-money accounts have a maximum cash-in limit of PhP 100,000 (US\$2,103) per person per month. E-money is explicitly not considered a deposit—it does not accrue interest, nor is it covered by deposit insurance under the Philippine Deposit Insurance Corporation. Circular 649 also defined three categories of e-money issuers (EMIs): (i) EMI-Banks; (ii) EMI-Nonbank financial institutions (NBFI) supervised by BSP; and (iii) EMI-Others<sup>62</sup> (nonbank institutions registered with BSP as money transfer/remittance agents). The companies behind GCash (i.e., GXI) and more recently, Smart Money,<sup>63</sup> are in the EMI-Others category.

#### **b. Which linkages were identified and managed?**

The primary goal of Circular 649 was financial inclusion, as stated clearly in Section 1 of the regulation, which gives context to BSP's wider goal of promoting the "availability and acceptance of e-money as a retail payment medium."<sup>64</sup> Interviews with BSP, market players, and industry experts show that BSP identified and managed linkages among the four I-SIP policy objectives, balancing a range of regulatory concerns, such as

the safety of digital stored value, AML/CFT risks, and consumer protection concerns with the potential of e-money to drive financial inclusion.

To support the implementation of Circular 649, in 2010, BSP issued Circular 704, which provided guidelines on outsourcing of services by EMIs to electronic money network services providers. This regulation allowed EMIs to outsource any of the following activities:

- Converting cash to e-money and monetizing e-money.
- Transferring funds from one electronic wallet to another.
- Using e-money as a means of payment for goods and services.
- Conducting other similar and/or related e-money activities or transactions.

EMIs are also required to report the list of accredited agents and aggregate statistics on agent operations to BSP. They must remain accountable to BSP for their agents' adherence to applicable regulation, including KYC at every cash-in/cash-out point and reporting of suspicious transactions.

**Linkages between inclusion and stability.** After a few years of pilot-testing GCash, when nonbanks that were "not as big or sound as GXI"<sup>65</sup> expressed interest in entering the market, BSP felt the need to issue e-money regulation for both banks and other players—hence the issuance of Circular 649 in 2009. Given BSP's apprehension about new nonbanks entering the e-money market

61 Various payment instruments can be used to store e-money value, including cash cards, e-wallets on mobile phones, stored-value cards, and similar products.

62 EMI-Others is a new category of institutions that was given a framework under Circular 649.

63 In 2013, Smart Money was spun off into a separate subsidiary (Smart eMoney, Inc., which was recently renamed PayMaya, Inc.) and registered as an EMI-Other.

64 BSP Circular 649.

65 Interviews with BSP, August 2015.

and the safety of customers' digital stored value, BSP placed a high minimum paid-up initial capital requirement of PhP 100 million (US\$2.1 million) for EMI-Others. BSP also required existing money transfer agents that wished to become an EMI-Other (but whose core business was not related to e-money) to spin off and be incorporated as a separate entity, which would be under the supervisory authority of BSP. BSP also assumed that bigger, more mature companies that could meet the high initial capital requirement would also be more capable of executing the e-money business. In addition, Circular 649 required EMIs to provide BSP with quarterly reports on their investments, volume of transactions, total outstanding e-money balances, and liquid assets. To further ensure the safety of customer funds, and to minimize risks associated with intermediation of such funds, BSP required that EMI-Others and EMI-NBFIs not engage in extending credit unless they secure a quasi-banking license from BSP.<sup>66</sup>

**Linkages between inclusion and integrity.** In 2000, the Philippines was placed on the Financial Action Task Force (FATF) list of Non-Cooperative Countries and Territories (NCCT), prompting the passage of the strict Anti-Money Laundering Act of 2001 and its implementing rules and regulations. Although the Philippines was removed from the FATF NCCT list in 2005, this was the backdrop under which BSP operated. Thus, Circular 649 covered AML/CFT issues by requiring EMIs to ensure that their agents comply with existing AML/CFT regulations. For EMIs, the ID requirement can be particularly challenging in remote areas, especially in the absence of a

national ID system. BSP tried to manage this particular challenge by issuing Circular 608 in 2008 and subsequent regulations,<sup>67</sup> which lightened KYC requirements for covered institutions from two valid photo-bearing IDs to one ID, and extended the list of acceptable IDs, such as letters certified by the barangay (smallest government unit) leader to validate the customer's identity.

**Linkages between inclusion and protection.** Circular 649 explicitly requires EMIs to provide a consumer redress mechanism. In addition, for EMI-Others, it indicates a 1:1 ratio of issued e-money (aka "float") to cash or cash equivalents, which was a way for BSP to safeguard customer funds by ensuring that EMI-Others had enough liquidity to meet cash-in/cash-out obligations to their customers. Moreover, EMI funds can be held only in bank deposits or government securities; they cannot be lent out. BSP identified and tried to manage the tension between inclusion and protection: if it had treated e-money as a deposit, it would have limited EMIs to banks because under Philippine law banks have the sole legal authority to accept deposits (which would have precluded innovations such as GCash). By explicitly stating it was not a deposit, e-money was not covered under deposit insurance. In fact, the Philippine Deposit Insurance Corporation was consulted when the circular was issued, but given that e-money was not a deposit, it was not concerned about the regulation. Without deposit insurance coverage, there is a risk to customer funds in the event an EMI becomes insolvent. In addition, Circular 649 does not require the e-money float to be held in a trust

<sup>66</sup> Quasi-banking functions refer to borrowing of funds, for the borrower's own account, through the issuance, endorsement, or acceptance of debt instruments of any kind other than deposits, or through the issuance of participations, certificates of assignment, or similar instrument with recourse, trust certificates, or of repurchase agreements, from 20 or more lenders at any one time, for purposes of relending or purchasing of receivables and other similar obligations (Banking Laws of the Philippines Book II: The General Banking Law Annotated. 2011, and Manual of Regulations for Banks, Section X234.1).

<sup>67</sup> For example Circular 706 or the Updated Anti-Money Money Laundering Regulations.

or other custodial account, leaving e-money account holders to be treated as general creditors in the event of an EMI's bankruptcy, which would expose customers to the risk of losing funds to other creditors and a potentially lengthy process for repayment of their funds (Izaguirre, McGuire, and Grace 2015). However, BSP tried to minimize this risk by setting a high initial minimum capital requirement for EMI-Others—PhP 100 million (US\$2.1 million).

### c. What have been the observed effects so far on the I-SIP objectives?

**Inclusion.** With the advent of Smart Money and GCash, the Philippines is “among the most advanced mobile money markets in the world,” inspiring dozens of mobile money deployments globally but failing to reach the same scale that has taken place in Kenya or Pakistan (GSMA 2009). After the issuance of Circular 649, the market saw a growth of e-money accounts, transactions, EMIs, and agents—but not at the rate that BSP had hoped. In interviews, BSP discussed its initially high expectations for the take-up of the product—especially for remittances and money transfers. It viewed e-money as convenient, cheap, and quick, and admitted its surprise to see that pawnshops continue to have a bigger share in the remittance market despite higher costs.<sup>68</sup>

In 2010, the number of registered e-money accounts linked to mobile phones stood at 7.9 million, growing to 9.4 million accounts in 2015.<sup>69</sup> However, the number of active users<sup>70</sup> is much lower: GCash estimated about 400,000

monthly active users (20 percent of the 2 million GCash customer base) as of the end of 2014, while Smart Money estimated about 640,000 monthly active users (8 percent of Smart Money's 8 million registered customers).<sup>71</sup> The 9.5 percent activity rate in 2014 is very close to Findex 2014 results indicating that 9.3 percent of adults (over 15 years old) in the Philippines made a transaction from an account at a financial institution using a mobile phone (Demirgüç-Kunt et al. 2015).

Prepaid cards linked to e-money, which are offered both by Smart Money and EMI-Banks, can be used at ATMs, for online purchases, and can generally be used like debit cards. The number of these cards have grown more quickly than the number of accounts accessed by mobile phone: from 11.5 million such accounts to 26 million over the same time period (2010–2015). For all e-money transactions, both via prepaid cards and mobile-phone based accounts, the flows into the e-money system increased by 107 percent over five years, from PhP 221 billion (US\$4.6 billion) in 2010 to PhP 456 billion (US\$9.6 billion) in 2015, while the number of transactions more than doubled, from 138 million in 2010 to 327 million transactions in 2015.

Following the issuance of Circular 704, the number of registered agent outlets grew from 8,819 in 2010 to 23,781 in 2015, a growth of over 170 percent. However, the number of active agent outlets (defined by EMIs as those currently allowed to process cash-in/cash-out transactions) remains relatively lower, at 19,270 in 2015—an 81 percent activity rate for all agents.

68 Interviews with BSP, August 2015.

69 Unless otherwise noted, all data for this section are provided by BSP.

70 Definition of active accounts differs slightly: for GCash, activity is one transaction over the past month; for Smart Money, activity is one transaction within the past 30 days.

71 Estimates provided by interviews with providers, August 2015. However, it is possible that these figures include some of the same e-money users—due to the lack of interoperability between the two platforms, some people may have both GCash and Smart Money.

E-money innovations in the Philippines go beyond remittances (domestic and international), airtime top-ups, and bill payments. For example, GCash partnered with the World Food Programme and Smart Money partnered with Land Bank of the Philippines<sup>72</sup> and the UN Development Program to disburse funds after Typhoon Haiyan hit the Visayas Islands in 2013. In partnership with Land Bank, GXI has disbursed PhP 5 billion (US\$105 million) to participants of the Pantawid Pamilyang Pilipino Program (4Ps), the conditional cash transfer program of the Department of Social Welfare and Development (DSWD).

Omnipay, an EMI-NBFI, finalized a partnership with Land Bank and DSWD in 2015, and plans to issue more than 4 million cards to beneficiaries in the 4Ps program over 18 months. Migrating conditional cash transfer beneficiaries to e-money will have a positive effect on both inclusion and integrity, since Omnipay cards can also be used as a valid ID to access financial services. Omnipay has also partnered with the city of Bacoor to issue a city ID card that also functions as a payment card that can be used by the city to transfer government-to-person (G2P) payments. The ID card covers two balances: one funded by the government (whose use is restricted to, for example, drugstores, hospitals, and schools, and

cannot be used in casinos, pubs), and a “citizen’s balance,” which has no restrictions.<sup>73</sup> These G2P products are important, in part, because they are often the gateway products to other financial services. One challenge is to promote their use. A way to do this is by offering a suite of products. Smart Money recently partnered with Land Bank of the Philippines to offer Loan Saver, the first fully electronic, mobile-based, salary loan program with insurance features. The program has a loan portfolio of PhP 3 billion (US\$63.1 million) and over 21,000 borrowers. Smart Money plans to offer a similar salary loan product with private-sector banks.

**Stability.** BSP’s decision to set high entry barriers for EMI-Others has limited the number of market players within that category. However, the minimum paid-up capital requirement of PhP 100 million (US\$2.1 million) was limited to just this new type of actor to ensure that they have sufficient resources for long-term, sustainable operations. For EMI-Banks (comprising mostly commercial banks and a few thrift banks), the number increased from 20 in 2010 to 29 EMI-Banks in 2015.<sup>74</sup> In the same period, two EMI-NBFIs (Omnipay and Metrobank Card) and four EMI-Others (including GXI and Smart e-Money, Inc.) were authorized by BSP (Table 4).

**TABLE 4. Number of EMIs in the Philippines**

E-money issuers	2010	2011	2012	2013	2014	2015
EMI-Banks	20	23	24	27	26	29
EMI-Nonbank financial institutions	–	–	–	1	1	2
EMI-Others	1	3	3	4	4	4
<b>Total</b>	<b>21</b>	<b>26</b>	<b>27</b>	<b>32</b>	<b>31</b>	<b>35</b>

Source: BSP.

<sup>72</sup> Land Bank of the Philippines is a universal bank owned by the Philippine Government that focuses on serving the needs of farmers and fishermen.

<sup>73</sup> Data from interviews with Smart Money, GCash, and Omnipay in August 2015.

<sup>74</sup> This net increase six EMI-Banks is the result of an increase in the number of commercial banks that offer e-money, as opposed to an increase in the total number of commercial banks.

Interviews with providers indicate that Circular 649 conferred a stamp of approval on their services. EMI status reassured customers that GCash and Smart Money are regulated by BSP. This helped to build customer trust in the product and led to the opening of new accounts. However, providers expressed concerns that the rules would constrain some providers, while other market players could bypass the system and potentially up-end the market. For example, some market players offer payment cards that are accepted at various merchants using defined closed-loop systems. However, because these stored-value cards cannot be converted to cash, they fall outside the definition of e-money and, therefore, outside the purview of BSP.

**Integrity.** Providers strongly indicated that complying with KYC rules is costly. Prior to Circular 649, customers could register for GCash through their mobile phones and could immediately send transfers to other GCash users. However, pursuant to Circular 649, EMIs were required to follow AML/CFT regulations, which meant conducting face-to-face KYC processes to on-board customers. This increased providers' sales and distribution costs because they now had to comply with additional requirements for physical outlets (as opposed to being able to leverage mobile channels) and use an accreditation process to conduct KYC assessments. However, subsequent regulation, BSP Circular 706 of 2011, gives a slight concession regarding KYC for low-risk customers in that some of the required minimum information to open an account may be collected within a reasonable time frame not exceeding 90 days. This deferred acceptance of account opening information gives e-money issuers some flexibility.

In addition, the Philippines' lack of a national ID system is still a stumbling

block for EMIs that operate in rural areas, given that the ID must have a photo, including certified letters from barangay leaders. There is also no national SIM card registry, which would help resolve KYC requirements. Given the operational challenges of registering more than 90 million prepaid SIM cards already in the market, telecoms are opposed to a proposed measure for SIM card registration. Moreover, for banks, there is a need for traditional paper documentation. For BankKO, the first mobile phone-based savings bank in the Philippines, the need for physical documents is a huge burden. A BankKO agent is allowed to register a new customer only when opening an e-money account. This account can be transformed into a full-service bank account only when the physical documents reach the head office and are reviewed by a bank officer. The process is also difficult for customers to understand.

Providers would like to see a more proportionate KYC approach for lower-value accounts, such as a tiered system based on account thresholds—in the words of one provider, “If you want 100 percent stability and integrity, financial inclusion suffers. Who will money launder for PhP 2,000 (US\$42)? Does it matter for microtransactions? But what if they do them anyway in cash, which is not traceable?”<sup>75</sup>

**Protection.** As of 2015, the top consumer e-money complaint to BSP centers on its perceived expiration. EMIs indicate that although e-money does not expire, after two years of inactivity, it is considered dormant, and dormancy fees are charged. The resulting consumer and regulator confusion suggests a need for greater clarity and transparency on this issue. In addition, Circular 649 does not address several other consumer protection considerations, including data

<sup>75</sup> Interview with providers, August 2015.

privacy, security, confidentiality, and network downtime (McKee, Kaffenberger, and Zimmerman 2015). BSP hopes to address these consumer protection issues with Circular 857 (Financial Consumer Protection Framework), which covers all BSP-supervised institutions, including EMIs.

Regulators view e-money in the Philippines as a retail payments channel that may lead customers to use a wider suite of financial products, as opposed to a digital “deposit-like” stored value, thereby negating the need for deposit insurance. BSP data on inflows and outflows seem to support this viewpoint: in 2015, PhP 456 billion (US\$9.6 billion) flowed into the system, and PhP 460 billion (US\$9.68 billion) flowed out, with similar rates in previous years. However, customer funds are currently lacking protection in case an EMI fails. The increasing role of EMI-Others in the provision of e-money raises customer risks in terms of the potential for losses, if a nonbank EMI fails with no customer safeguards in place (e.g., by setting up a trust framework where customer funds are required to be deposited in a trust or custodial account). On the other hand, BSP sought to address this concern by setting a high minimum capital requirement for EMI-Others of PhP 100 million (US\$2.1 million), requiring a 1:1 ratio for the float and requiring the establishment of a separate entity to conduct EMI business for supervision under BSP.

Another consumer protection concern is that e-money, according to Circular 649, has to be withdrawable in cash to be defined as e-money and regulated as such. However, there is a risk that providers issuing instruments via closed-loop payment cards (which are not convertible to cash yet are accepted at a wide range of merchant establishments) do not

meet the definition of e-money and are therefore not monitored or regulated either from a prudential or market conduct perspective.

#### **d. What have we learned about managing linkages and optimizing results?**

**Definitions.** In the Philippines’ national-level definition of financial inclusion (see Section 2.3), there are dimensions of physical access, usage, quality, and welfare, along with references to savings, credit, payments, remittances, insurance, and investments.<sup>76</sup> While Circular 649 does not explicitly define any of the four I-SIP policy objectives, there are some implicit definitions. Section 1 of the Circular states BSP’s objective “to foster the development of efficient and convenient retail payment and fund transfer mechanisms” relates to the mention of payments in the national-level definition of financial inclusion. In addition, “efficient” and “convenient” retail payment mechanisms also allude to aspects of “effective access,” particularly with regard to customer use and quality of service. Moreover, the regulation’s definition of e-money and EMIs has provided guidance to the financial sector on BSP’s concept of this inclusive financial service.

**Structured approach.** The linkage between inclusion and stability, especially with regard to establishing EMIs, was explicitly considered in the regulation. Financial integrity was addressed by way of requiring EMIs to comply with existing AML regulation, but did not receive much attention in the regulation otherwise. Protection issues were considered to a certain extent (e.g., redress mechanism for complaints, clear language requirements) but other concerns such as data privacy, security, and confidentiality are not addressed.

<sup>76</sup> National Strategy for Financial Inclusion, July 2015.

**Inter- and intra-agency collaboration.**

BSP consulted with the Philippine Deposit Insurance Corporation before issuing Circular 649. However, there seems to be a lack of coordination with the National Telecommunications Commission (NTC).<sup>77</sup> NTC's knowledge about telecom operators' delivery of financial services is limited and could be strengthened by more collaboration with BSP.

**Data.** BSP collects a range of data points from EMIs on a quarterly basis. This enables it to monitor the effects of policy intervention. However, BSP allows EMIs to provide their own definition of customer use rates (ranging from activity within one month to activity within six months), which makes it difficult to compare use rates across providers. At the same time, BSP is engaged in an ongoing effort to revise the e-money reporting template to collect a uniform set of mobile financial services indicators from EMIs.

**Consultations with providers.** During the GCash pilot phase, banks were advised not to partner with GXI until BSP became fully aware of the risks of the new model. In this regard, BSP managed stability concerns yet still allowed the innovation to be tested and piloted in the market. In addition, EMIs regularly approach BSP with ideas for new products and services to receive early feedback. Providers have widely praised BSP as an approachable regulator that makes a priority of consulting with them as policies and regulations are introduced or changed.

At the same time, BSP could have done more to address some of the provider-related consumer protection issues,

such as the lack of interoperability among EMIs and provider business practices that create confusion among consumers, such as a perception that e-money can expire (due to provider dormancy charges). In the eyes of consumers, e-money is a complicated product that they do not fully understand—unlike, for example, pawnshops, which can provide similar services and thus present competition to EMIs. Moreover, providers admit the challenge of providing a consistent quality of customer experience across all touch points and to provide a user-friendly interface. As a result, the potential of e-money as a gateway to basic financial services for the unbanked has not been fully realized. Although it is the pioneer of mobile money, the Philippines' efforts have since been eclipsed by highly successful mobile money deployments in several countries across East Africa and South Asia.<sup>78</sup>

**Policy adaptation.** BSP's approach to periodically reviewing regulation enables the regulator to try to optimize linkages while minimizing trade-offs. For example, BSP is considering the possibility of amending e-money regulations to include a trust vehicle for e-money float, in light of the current levels of e-money, the conditions of EMIs, and the potential impact of bringing 5 million conditional cash transfer beneficiaries into the system. This would address the link between inclusion and protection. BSP also is considering digital KYC,<sup>79</sup> which could address some of the financial integrity challenges providers face. Moreover, it is revisiting Circular 649 to determine the feasibility of expanding the definition of e-money to include cards/instruments that are strictly used

77 When Smart Money and GCash emerged, NTC was consulted, but it did not raise any concerns because these products deal with money transactions, which are not under NTC's purview.

78 See <https://www.cgap.org/blog/20-years-financial-inclusion-east-africa-4-major-shifts>.

79 For example, Lenddo, a third-party service, could help providers verify the identities of their customers using data from social networks and other forms of "big data."

for payments but are widely accepted by different merchants and in different establishments. The fact that these instruments do not meet all the criteria of e-money as defined in Circular 649 and thus fall outside BSP authority may lead to both consumer protection and unfair competition concerns. In view of this and other consumer protection challenges already mentioned, BSP needs to further adapt policy with respect to clarifying e-money definitions and regulating provider practices.

### 3.4 Regulations for Microbanking Offices

#### a. The policy change

In 2001, BSP partially lifted the moratorium on the establishment of new banks and branches to enable the entry of new banks that focus on the microfinance market,<sup>80</sup> and to allow existing banks to establish new branches anywhere in the country, as long as these branches are microfinance-oriented. Subsequent regulations allow the establishment of loan collection and disbursement points (LCDPs) so that microfinance-oriented banks can disburse and collect loan repayments outside bank branches. This is necessary to accommodate the microfinance methodology of lending to groups that meet weekly in local centers.<sup>81</sup> Since this method also involved collecting embedded deposits,<sup>82</sup> authority to solicit deposits outside bank branches was also granted to microfinance-oriented banks with LCDPs. Aside from branches and LCDPs, existing regulations allowed

for other types of banking access points (extension offices, regular other banking offices). While these regulations were in effect, the banking landscape was changing as a result of bank consolidations, mergers, and acquisitions.

Thus in 2010, BSP issued Circular 694, which consolidated and rationalized branch rules. Circular 694 allowed the establishment of two types of scaled-down offices: (i) other banking office (OBO), which provides nontransactional banking-related services, and (ii) microbanking office (MBO), which provides limited transactional banking activities. According to the Circular, this is in line with BSP's goal to "promote and maximize the delivery of efficient and competitive banking services especially to underserved markets and customers through innovative policies."

OBOs and MBOs enable banks to have a presence in areas where it may not be immediately economically feasible to set up a full-fledged bank branch. OBOs are allowed to market bank products, accept loan applications and documents for account opening, and provide customer care services, among other services. MBOs, on the other hand, are allowed to perform the functions of OBOs plus a range of financial services such as accept microdeposits, disburse microloans, sell microinsurance, make limited purchases of foreign currency, conduct bill payments, handle government subsidies, and convert to and from e-money. These activities were determined to

80 BSP Manual of Regulations for Banks, Section X102.2, suspended granting of new bank licenses/ establishment of new banks except in cities and municipalities where there are no existing banking offices to address over-saturation in some areas and promote mergers and consolidations. This was in effect as of 16 August 1999. The moratorium was formalized under Section 8 of Republic Act No. 8791, the General Banking Law of 2000, which disallowed the establishment of banks for a period of three years from its effective date. Several regulations have henceforth been issued to rationalize guidelines in the establishment of new banks/branches. The moratorium was partially lifted by BSP Circular No. 273 to enable the establishment of microfinance-oriented banks/branches anywhere in the country. Most recently, Circular 902 issued on 15 February 2016 instituted the phased lifting of the moratorium on the grant of new banking license or establishment of new domestic banks.

81 BSP Circular 273, 27 February 2001, BSP Circular 340, 30 July 2002.

82 As part of the group lending methodology, a portion of the weekly loan amortization is allocated as savings of the borrower.

be the most needed by microfinance customers and overseas Filipinos and their beneficiaries (i.e., remittance recipients). The regulation requires that at least 50 percent of the number of transactions conducted by MBOs be with microfinance customers (defined as customers who avail of any microfinance product).<sup>83</sup>

Banks that intend to establish MBOs have to meet prequalification requirements that include, for example, having a composite CAMELS rating of at least 3 with a management component score not lower than 3.<sup>84</sup> The applicant bank must not be under prompt corrective action,<sup>85</sup> and must have no major supervisory concerns. Banks that meet minimum criteria can be authorized to establish MBOs after they submit a business plan that incorporates the MBOs. MBOs' records of accounts are not kept separate and are to be reconciled with the records of an identified branch or head office. Banks shall also ensure that activities done in MBOs are subject to appropriate internal controls. As indicated in the regulations, requirements for MBOs are proportionate to the proposed activities that banks want to perform in the MBOs. This is determined during the evaluation of the application. For example, if the bank proposes to do only loan disbursements in the MBO and does not envision keeping any cash on hand at the end of the day, the bank need not specify the presence of a vault on the MBO premises. The requirements that are considered when MBOs are approved will depend on what the bank indicates as the planned activities in its MBOs.

## b. Which linkages were identified and managed?

The primary goal of Circular 694 was financial inclusion. MBOs provide a way to establish a banking presence in areas that are unserved or underserved and where traveling to a bank branch may be prohibitive in terms of cost. In this regard, basic transactional services can be provided in these offices, as long as the bank specifically applied for and was authorized by BSP to offer such services. Such services are also designed to meet the needs of the unserved and underserved (e.g., microdeposits, microfinance loans, limited foreign exchange, and conditional cash transfers). The requirement that 50 percent of total number of MBO transactions be with microfinance customers is another inclusion goal, although some banks initially found it hard to meet.

Interviews with BSP and market players showed that BSP identified and managed linkages among the four I-SIP policy objectives, balancing a range of regulatory concerns such as the safety and soundness of bank operations, financial integrity risks, and consumer protection concerns, with the potential of MBOs to expand physical reach of financial services.

**Linkages between inclusion and stability.** BSP crafted the MBO regulations with financial stability in mind. The prudential requirements (i.e., CAMELS rating, management quality, not under Prompt Corrective Action, no material supervisory issues) are aimed at ensuring that only strong and capable

83 Microfinance products include microfinance loans (e.g., microenterprise loans, microagri loans, special "microfinance plus" loans for growing microenterprises, housing microfinance loans), microdeposits, and microinsurance.

84 CAMELS stands for Capital adequacy, Asset quality, Management, Earnings, Liquidity, and Sensitivity to market risk. It is a supervisory rating system that is used to classify a bank's overall condition, where 5 is the highest score and 1 is the lowest score that can be assigned to each of the six components of the composite rating indicator.

85 Prompt corrective action essentially involves BSP directing the bank to implement strong measures (e.g., capital restoration plan, business improvement plan, corporate governance reforms) to return to a normal operating condition within a reasonable period.

banks are able to expand outreach. Since MBOs can perform transactional banking services, they are subject to additional requirements to ensure safe and sound operations. These specific requirements pertain to internal control procedures that must be in place, such as physical facilities and security arrangements, timely accounting and proper recording of transactions, periodically reviewed manual of operations, and a responsible officer who has adequate training in microfinance. The bank must also ensure that its MBOs follow the maximum onsite cash limit of PhP 500,000 (US\$10,513) per day.

BSP created an MBO Task Force<sup>86</sup> after issuing Circular 694 as another link to stability. The Task Force was responsible for evaluating bank applications for establishing MBOs. BSP realized that the Task Force could expose potential tension between inclusion and stability, but was willing to take on this balancing act. The Task Force deliberated on issues arising from bank MBO operations. For example, if a bank begins to expand too rapidly or if the lack of adequate training for loan officers results in higher delinquencies, then the Task Force considered this when it reviewed and processed MBO applications.

**Linkages between inclusion and integrity.** MBOs follow the same AML/CFT framework imposed on banks, since they are still banking offices. Thus relaxed KYC requirements in terms of reducing the number of IDs required from two to one, and accepting a wide range of valid IDs also apply to MBOs. Still, the main issue of operational challenges and added cost of on-boarding rural customers

who do not usually have a photo-bearing ID remains.

The original intention regarding deposit-taking was for consumers to be able to complete the process, from application to account opening to acceptance of the initial deposit, at the MBO. However, the proviso under Circular 694, as articulated under Section X151 of the Manual of Regulation for Banks, did not fully capture this intention. The regulation states that OBOs can “perform customer identification process, receive account opening documents and facilitate account activation: Provided, that account opening approval and actual opening of deposit accounts shall be done only at the head office/branches/extension offices.” Therefore, in the implementation of Circular 694, BSP examiners were requiring the bank to ask its customers to go to the head office or branch to open their account before they could make the initial deposit in the MBO. In this regard, BSP issued a policy amendment to capture the entire procedure for opening microdeposits, including approval, account opening, and the making of an initial deposit directly at the MBO. Since MBOs do not manage their own books, these activities require that they have the necessary internal controls in place.<sup>87</sup>

**Linkages between inclusion and protection.** The BSP Financial Consumer Protection Framework<sup>88</sup> imposed on banking institutions also applies to MBOs. Thus the principles of transparency, fair treatment, privacy of personal information, effective redress, and financial education are observed by MBOs. The same is true with the regulation on

86 The Task Force was headed by the Central Applications and Licensing Group, the BSP unit handling and processing all licensing applications of banks. After the dissolution of this unit and the Task Force in 2014, its duties were transferred to various BSP offsite examination departments. The organizational change appears to be a more logical since the offsite examination departments are the central contact points of banks when coordinating with BSP.

87 BSP Circular 901, 29 January 2016.

88 BSP Circular 857, 21 November 2014.

truth-in-lending,<sup>89</sup> which requires using the effective interest rate and declining balance method when computing loans and prescribes a standard form of disclosure to ascertain that every borrower is given information that is simple and easy to understand.

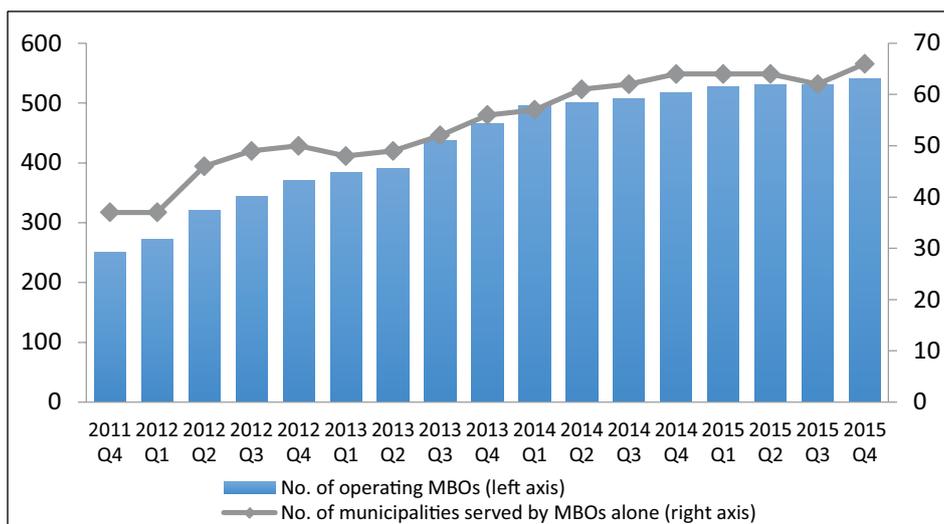
**c. What have been the observed effects so far on the I-SIP objectives?**

**Inclusion.** The observed effect on financial inclusion is positive and in line with what BSP envisioned when the MBO regulation was crafted. By the end of 2011, one year after the Circular was issued, 251 MBOs were established in 138 local government units (i.e., cities and municipalities); 37 municipalities had only MBOs and not regular branches. Four years later, the number of operating MBOs increased by 115 percent to 540 MBOs. These MBOs were present in 338 local government units, 66 of which were being served by MBOs alone (Figure 4).

In addition, OBOs and MBOs play and increasingly strategic role in reaching areas that were previously unbanked. In 2012, three out of 10 (30 percent) municipalities that were unbanked the previous year gained banking presence because of MBOs. In 2013, 11 out of 15 (73 percent) municipalities that became banked gained banking presence through OBOs and MBOs. In 2014, all 19 municipalities that became banked gained banking presence because of OBOs and MBOs.

Banks have welcomed and taken advantage of the opportunities presented by the MBO policy. The number of banks with MBOs increased to 39 in 2015 from just five banks in 2011. Because of MBOs, these banks are able to extend their physical reach at lower infrastructure costs. Data from one bank indicate that monthly operating expenses are seven to eight times lower for MBOs compared to operating expenses for traditional bank branches.<sup>90</sup>

**FIGURE 4. Number and reach of MBOs, 2011–2015**



Source: BSP.

<sup>89</sup> BSP Circular 730, 20 July 2011.

<sup>90</sup> This is exclusive of one-time capital expenditures (ranging from US\$65,000 to US\$130,000) needed in leasing or owning a building for a regular bank branch.

In light of the benefits brought about by MBOs, an internal policy study was conducted by the BSP's Inclusive Finance Advocacy Staff (see Section 2.1) in 2014 to investigate how the regulations can be further enhanced to promote the establishment of banks in unbanked communities. The study analyzed the characteristics of banked and unbanked municipalities, and showed that setting up branches will obviously push banks to higher income, more populated areas. The costs of establishing banking offices (including the fees paid to BSP for processing and licensing) and operating such offices may be too significant an investment to justify serving a rural area with relatively low population density. However, there are unbanked municipalities whose level of economic activity is not necessarily low, suggesting that there are still untapped opportunities for banks.

Because MBOs deliver financial services in underserved areas and, more importantly, often are the only banking service access point in some previously unbanked areas, the study recommended that expanding the range of products and services that MBOs can offer can be a viable proposition.<sup>91</sup> The study also suggested that incentives, such as exemption from BSP processing fees<sup>92</sup> (which can further enable banks to lower the cost of establishing a presence in unbanked areas) can be effective.

As a result of the study, BSP issued Circular 868 in January 2015. The Circular expands the range of services that MBOs can deliver to include not only microfinance loans but also other loans (e.g., salary, educational, and health loans) to microfinance customers.

The expanded services still cater to the intended market of MBOs, and the prudential requirements and operational controls are retained. The Circular also waives the collection of BSP processing fees for banking offices that will be set up in unbanked cities and municipalities as an incentive for banks to establish branches in unserved areas.

**Stability.** There does not seem to be a negative effect on stability. While there are limited data on MBO transactions because these are recorded on the books of the branch to which the MBO is attached, there are still indications that MBOs help to improve a bank's financial performance.

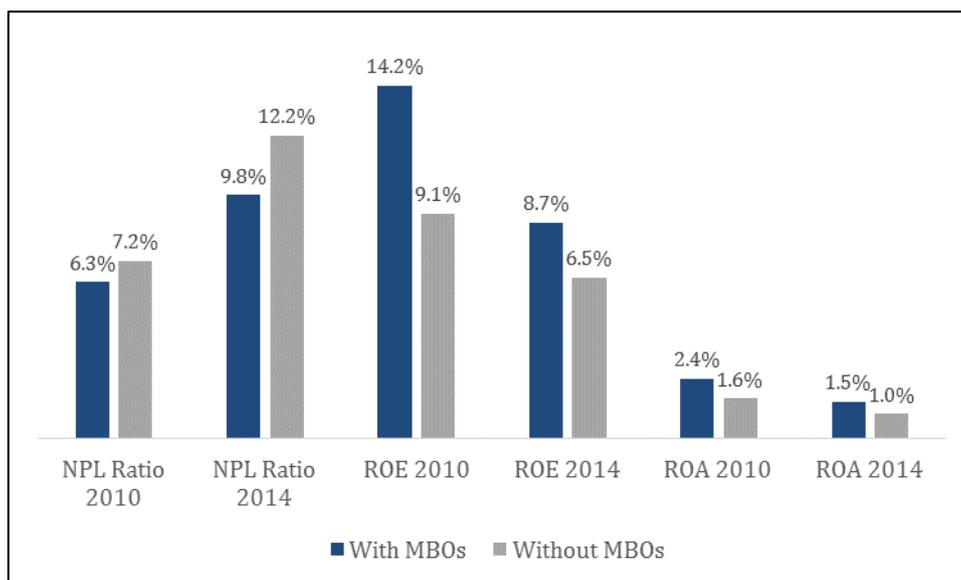
For one of the key players in the MBO market,<sup>93</sup> both deposits and loans had an average growth of 23 percent in the four years after Circular 694 was issued. The bank attributes this to the MBO policy, which makes it better able to reach areas that were previously too difficult to reach. Although its return on equity (ROE) slightly declined to 28.2 percent in 2014 from 31.3 percent in 2010, its return on assets (ROA) increased to 6 percent in 2014 from 3.6 percent in 2010. These data suggest that the establishment of MBOs has contributed to increased deposit-taking and improved profitability of this bank, though more granular data are needed to determine how much of this growth can be attributed to serving the previously excluded.

It is also worthwhile to compare the performance of microfinance-oriented or microfinance-engaged banks (see Section 3.2) with and without MBOs. As shown in Figure 5, before Circular 694

91 The MBO Task Force in its accomplishment report also noted the positive impact of the MBO policy and put forward the merits of the expansion of MBO products and services.

92 Branch processing fees range from PhP 5,000 (US\$105) to PhP 200,000 (US\$4,205), depending on bank type and branch location.

93 For this bank, 91 percent of loans are dedicated to microfinance, and 81 percent of its banking offices are MBOs.

**FIGURE 5. Comparison of microfinance banks with and without MBOs**

Source: BSP.

was issued in 2010, microfinance banks that established MBOs were performing better than microfinance banks without MBOs in terms of asset quality (nonperforming loan [NPL] ratio) and profitability (ROA, ROE). In 2014, microfinance banks with MBOs maintained better asset quality and profitability indicators than microfinance banks without MBOs.

Overall, there appears to be limited stability risks related to MBOs. The safeguards included in the MBO regulations help to create an ecosystem of strong and well-managed banks that are responsive to the needs of the underserved market. In the long run, it is expected that increased access to financial services will lead to a more stable retail deposit base and a more diversified loan portfolio for these banks.

**Integrity.** There appears to be a positive effect on integrity. Since MBOs are considered bank offices, they must comply

with all AML/CFT standards imposed on banks. Customer on-boarding and reporting responsibilities also apply to MBOs as part of the operations of the branch to which it is attached. In this regard, the creation of an MBO does not add to the financial integrity risk of the bank because it is under the same framework of supervision and regulation.

The low thresholds of transactions<sup>94</sup> in MBOs make it likely that the transactions will not be considered “covered transactions” under AML/CFT rules. Suspicious transaction reporting is still required and should be done under the bank’s overall AML compliance framework.

**Protection.** The effect on protection appears to be positive. MBO customers benefit from financial consumer protection standards and truth-in-lending regulations imposed on banking institutions and are, thus, better off compared

<sup>94</sup> Allowable MBO transactions include microfinance loans (maximum threshold of PhP 300,000 [US\$6,300], depending on product type), microdeposits (average daily balance of PhP 40,000 [US\$841]), foreign currency purchase (maximum of US\$100 directly deposited to microdeposit accounts), microinsurance (daily premium estimated at PhP25 [US\$0.53] or 7.5 percent of the current minimum wage of nonagricultural workers), low-value payments, and conditional cash transfer payouts.

to when they transact with the informal sector. For one, according to the Truth in Lending Act of 1963 (Republic Act 3765), customers transacting with an MBO should be afforded material details of a financial instrument or service before a transaction is made. They should also be given fair treatment such that they are offered products that are suitable and responsive to their financial needs. The privacy of personal information of MBO customers should be protected. For instance, the Financial Consumer Protection Framework of BSP prohibits the sharing of a customer's information even with the bank's subsidiaries and affiliates for marketing purposes and referrals. MBO customers can also contact BSP if they have complaints about BSP-supervised financial institutions. Financial education and awareness are also promoted by BSP to its constituent banks, which ultimately benefit their customers.

Since the institutionalization of MBOs in 2010, BSP has not received any complaints from MBO customers. The absence of complaints from these customers is consistent with the fact that from 2011 to mid-2015 (four-and-a-half years) there has been only seven microfinance-related concerns lodged with BSP.<sup>95</sup> (The BSP Financial Consumer Protection Department typically receives 7–30 “complaints, inquiries and requests” from clients of supervised institutions and the general public daily.) The low rate of complaints may be because MBOs offer microfinance clients transactions that are rather simple, convenient, and locally accessible, which maximizes the customers' comfort. At the same time, disaggregation of complaints data may help to identify complaints specifically related to MBOs.

The forthcoming full enforcement of the BSP regulations on Financial Consumer Protection,<sup>96</sup> which will cover all BSP-supervised institutions (including banks and their MBOs), is expected to ensure greater consumer protection for clients transacting in MBOs, and result in a potentially more comprehensive capture of complaints data.

#### **d. What have we learned about managing linkages and optimizing results?**

**Definitions.** BSP is committed to continuously promoting MBOs as a viable and sustainable solution in increasing access to a wide range of affordable financial services, which is part of the definition of financial inclusion.

**Structured approach.** A regular review of regulations, including inter-relationships with other regulations, is necessary to ensure that positive linkages are optimized and negative linkages are minimized. For instance, the “50 percent requirement” for MBOs is subject to regular review and may be amended if deemed appropriate. The ongoing review of the Circular 706 provision on KYC and minimum basic ID requirement is informed by banks' difficulties in on-boarding currently unbanked customers. BSP regulations on consumer protection, particularly the adoption of Circular 857 in 2014, ensure that consumer protection standards will be applicable to all types of banking offices, including MBOs.

**Inter- and intra-agency collaboration.** The creation of the MBO Task Force facilitated coordination among different BSP departments. The importance of further intra-agency collaboration was

<sup>95</sup> These include four lending concerns (loan proceeds, fees, restructuring, collection harassment), one deposit concern, one about disputed/payable balance, and one about the letter of authority to operate.

<sup>96</sup> Circular 857, dated 21 November 2014. The regulations cover five consumer protection standards of which some are in place, while others are in the early stages of implementation.

highlighted by the I-SIP research given a constant need to nurture a shared understanding of the MBO regulatory framework among policy-making and examination units to ensure appropriate enforcement. Because MBOs are within the regulatory sphere of BSP, collaboration with agencies outside BSP has not been necessary. However, with the launch of the National Strategy for Financial Inclusion in 2015, greater interagency collaboration and private-sector engagement is envisioned. The collaboration may include sharing information and discussing how to maximize the opportunities presented by BSP regulations that promote financial inclusion, including the MBO policy.

**Data.** Potential linkages, whether positive or negative, need to be identified at the onset of regulations, and intentional measurement of these linkages through institutionalized data and reporting requirements needs to be exercised in the course of enforcing the regulation to ensure effective policy making using the I-SIP framework. In the case of the MBO regulation, the inclusion-stability linkage could be better appreciated with outreach data and analysis of loan portfolio quality. The lack of disaggregated data on MBOs, including the number of customers served and the origin of microfinance-related complaints, makes it difficult to conclusively measure customer outreach and determine whether customers are indeed satisfied with MBO services. The effect of AML regulations on inclusion cannot be fully measured given the lack of data on how many customers were not on-boarded by MBOs because of their lack of minimum basic ID requirements. BSP may explore how MBO reporting can be expanded to include the

information necessary to measure and assess the effects of MBO regulations.

**Consultations with providers.** BSP welcomes feedback from providers with MBO operations to ensure that the regulations remain responsive to the needs of providers and MBO customers. Policy enhancements, such as increasing the average daily balance of microdeposits, widening the range of allowable activities in MBOs, and waiving processing fees for banking offices to be established in unbanked areas, were informed by consultation and feedback from providers.

**Policy adaptation.** The I-SIP exercise brought to the fore the differences in interpretation of some provisions of Circular 649, particularly in regard to account opening and initial deposit-taking. This facilitated immediate BSP action to clarify the provisions through a proposed amendment of the regulation.

### 3.5 Draft Regulations for Pawnshops

#### a. Policy change

In a recent BSP survey, pawnshops are found to be the most used providers of financial services in the Philippines—about 52 percent of the adult population used pawnshop services.<sup>97</sup> According to BSP, in 2015, there were over 16,100 pawnshops registered in the country.<sup>98</sup> In addition to their main business of providing loans collateralized with personal property,<sup>99</sup> pawnshops have been increasingly active in offering other services—notably international remittances and domestic money transfers (including through the use of mobile banking), foreign currency exchange, and bill payments. About 42 percent of

97 BSP National Baseline Survey on Financial Inclusion, 2015, Section 2.3.

98 Unless otherwise noted, all data for this section are provided by BSP.

99 Personal property delivered and within control of the pawnshop (excluding real property).

pawnshops are engaged in such corollary business activities.<sup>100</sup> The pawnshop sector has been highly concentrated, with the 20 largest pawnshop networks serving 75 percent of the market.

Pawnshops are governed by Presidential Decree 114—Pawnshop Regulation Act—issued on 29 January 1973. The decree provides for a legal basis for establishing and operating pawnshops and entrusts BSP (then called the Central Bank) with the regulatory and supervisory authority over pawnshops. According to the decree, pawnshops are viewed as “an additional source of credit”; they may be established as a single proprietorship, a partnership, or a corporation, and they must be registered and licensed by the Central Bank.<sup>101</sup> Pawnshops in the form of single proprietorship must be owned by a citizen of the Philippines; for partnerships and corporations, the share of local ownership cannot be less than 70 percent. The decree also established a minimum paid-in capital requirement for a pawnshop of PhP 100,000 (US\$2,103) and maximum interest rates on pawnshop loans (by referring to the Usury Law of 1916, which, however, was suspended in 1982 hence is no longer applicable), and the maximum noninterest service charge of PhP 5 (US\$0.1) (but not to exceed 1 percent of the loan principal). The amount of a loan cannot be less than 30 percent of the pawned item value. The adoption of the decree was followed by implementing regulations in the same year—Central Bank Circular 374 of 13 July 1973.

Since 1973, there have been numerous BSP regulations on pawnshops activities. Two sets of regulations are particularly

important in light of the management of the I-SIP linkages:

1. BSP Circular 656 (2 June 2009) consolidated previously issued regulations and introduced fit-and-proper requirements for pawnshop managers, as well as “Know Your Pawner” requirements. The pawner’s identification process was based on at least one photo-bearing ID document out of twenty possible options. The circular also required that pawnshop owners attend AML and corporate governance seminars. From a prudential standpoint, the circular required pawnshops to comply with a “prudential capital ratio,” defined as a total capital requirement of at least 50 percent of the amount of the pledge loan portfolio up to PhP 3 million (US\$63,080), and an additional 30 percent of the portfolio in excess of PhP 3 million. The circular contains a number of consumer protection requirements, such as information to be included on a pawn ticket, and minimum disclosure of key terms and conditions. These provisions show BSP attempts at addressing integrity, stability, and consumer-protection issues.
2. BSP Circular 711 (28 January 2011) further focused on integrity, stability, and protection. It contained provisions on qualification and disqualification of employees and owners of pawnshops; required that at least one staff per pawnshop branch attend an AML seminar conducted by the Anti-Money Laundering Council<sup>102</sup> or one of its accredited providers; and required that pawnshops that do not meet the minimum paid-in capital or

100 Corollary business activities can include exchanging foreign currency, acting as bill payment agents for utility companies, and selling microinsurance (pawnshops must be separately licensed by the Insurance Commission to become microinsurance agents unless they act only as distributors of microinsurance policies, in which case no license is necessary).

101 Pawnshops must also secure local licenses such as business permits issued by local governments in their areas of operation.

102 The Philippines’ financial intelligence unit (<http://www.amlc.gov.ph/>).

the prudential capital ratio to submit a capital build-up program to BSP. Larger pawnshops (with assets of PhP 50 million [US\$1.05 million] and higher) were required to meet corporate governance requirements of the SEC. Additional consumer protection requirements included the minimum size of a pawn ticket, the minimum font size in which information should be presented on the pawn ticket, and customer notification procedures for pawnshops to follow when a pawned item is sold.

In 2011, BSP obtained approval from its Monetary Board for a pawnshop inspection program that would cover 600 pawnshops (including the largest 20) over a course of three years. While this represented a small percentage of the total number of pawnshops, the inspections covered a large portion of the market in terms of pawnshops' assets and number of clients served (over 75 percent). The results of these inspections provided important information that guided BSP's thinking behind a newly developed comprehensive set of draft BSP regulations to govern pawnshop operations.

The need for market consolidation was addressed by consolidating related pawnshops that operated as separate entities despite being branches of a larger entity, since many pawnshops registered as individual businesses, in fact, belonged to the same owners or pawnshop networks. According to

BSP statistics, of the more than 16,100 registered pawnshops, only about 5,600 were head offices, while about 6,500 were branches registered as separate pawnshops. The number of registered pawnshops has been growing fast. In 2014, there were over 2,500 new applications for pawnshop openings, and in the first six months of 2015 there were 1,000 applications—many of which included requests to register up to 50 new pawnshops. Owners may have several pawnshops because they want to take advantage of certain tax breaks, there is a low market entry barrier (as noted, the minimum capital requirement for opening a pawnshop has been PhP 100,000, or US\$2,103, since 1973), and there are relaxed corporate governance requirements for smaller pawnshops.

The large number of pawnshops is a burden on the supervisor and makes it difficult to assess related parties risks. In addition, such a large number of pawnshops—many of which are de-facto branches of pawnshop networks (and not necessarily registered in the name of the real owner)<sup>103</sup>—makes it very difficult to establish beneficial ownership of the pawnshops and enforce other AML/CFT requirements.<sup>104</sup> For example, as of mid-2015, very few pawnshops (9–10) were submitting reports on “covered transactions” and suspicious transactions.<sup>105</sup> To report these transactions, pawnshops must be registered with the Anti-Money Laundering Council; most of them have not

103 Pawnshops are first registered with local government units in their area of operation, then they present a business permit and an application for a license to BSP. Different local government units exercise different levels of due diligence to establish beneficial owners. BSP relies on the units' business permit issuance process. The mechanism of individual pawnshop registration makes it easy for a beneficial owner to get business permit for another pawnshop from another local government unit using the name of a relative or friend.

104 According to FATF (2014), “beneficial owner [. . .] includes those persons who exercise ultimate effective control over a legal person or arrangement.”

105 According to the Anti-Money Laundering Act, “covered transactions” involve an amount in excess of PhP 500,000 (US\$10,513) within one banking day. Reports on these transactions must be submitted to the Anti-Money Laundering Council.

106 In the ongoing re-issuance of Certificates of Authority to existing pawnshops, BSP also sends a letter explicitly requiring that pawnshops register with the Anti-Money Laundering Council within 30 days upon the receipt of the letter, otherwise a Certificate of Authority may be revoked.

registered yet.<sup>106</sup> Many pawnshops do not report their transactions to the Council because their average transaction amount is below the established amount for covered transactions (even though suspicious transactions must be reported regardless of the amount involved).

At the same time, pawnshops that engage in remittances are considered to be of medium to high risk from the AML/CFT point of view. As entities covered under AML/CFT rules, these pawnshops should conduct enhanced due diligence if they transact with clients from high-risk countries. While there are no limits on remittance transactions, AML/CFT rules require that suspicious transactions be reported.<sup>107</sup> A lot of pawnshops act as agents of remittance companies—there were over 6,600 such pawnshops as of the first quarter of 2015. The volume of remittances transferred through pawnshops appears to be growing;<sup>108</sup> Pawnshops are the second most popular means for sending and receiving both international and domestic remittances after remittance agents.<sup>109</sup> These factors make BSP concerned about the potential amplification of AML/CFT risks.

The need for market consolidation was also highlighted by BSP's observation that having multiple small pawnshops that offer various services beyond loans may not be in the best interest of consumers who would benefit from dealing

with larger networks—primarily for remittances, but for other services as well (such as credit at lower interest rates due to the economies of scale and thus improved efficiency of larger pawnshops).

Finally, in the course of the pawnshop inspection program, BSP discovered that there were pawnshops operating without BSP licenses. Although the number of these is estimated to be 3–5 percent of the total number of the pawnshops, this situation flags consumer protection concerns, including in view of some other consumer complaints.<sup>110</sup> In addition to stability and integrity objectives, BSP believes that the network approach to pawnshop regulation would facilitate the enforcement of consumer protection and market conduct rules.

Based on these deliberations, in 2015 BSP developed a new set of draft pawnshop regulations. The proposed regulations introduce four tiers of pawnshops to address the market consolidation goal:

1. Tier A is a basic pawnshop with not more than 10 offices and a minimum capital of PhP 100,000 (US\$2,103). This type of pawnshop cannot engage in corollary business activities and is the only type of pawnshop that can be a single proprietorship or partnership—all the other types must be established as corporations.<sup>111</sup>

107 Though international remittance companies such as Western Union must register with BSP, BSP does not have the authority to regulate their activities. BSP has been discussing this issue with the SEC to have it require these remittance companies to open local subsidiaries that BSP could regulate and supervise. Discussions are also underway with the Anti-Money Laundering Council given higher AML/CFT risks associated with the remittance business.

108 While there are no segregated data on remittance volumes sent through pawnshops, overall the volume of remittances sent through nonbanks in the Philippines (including money transfer operators, remittance companies, pawnshops, mobile banking, and door-to-door delivery—though the share of the latter has been declining) grew from 26.3 percent in 2010 to 35.2 percent in 2014.

109 In 2015, 39.1 percent of Filipino adults sent or received money via remittance agents; 33.3 percent did so via pawnshops.

110 So far there has been only one consumer complaint on a pawnshop that turned out to be operating illegally—i.e., without a BSP license—out of the total 687 pawnshop-related complaints received by BSP (or referred to BSP from other sources such as mass media) during 2006–2015. The top four consumer complaints include excessive charges (15 percent), lost pawn item due to robbery (13 percent), failure to issue notice to redeem/foreclose pawned item (11 percent), and altered/diminished/damaged pawned item (11 percent).

111 All pawnshops can engage in corollary business activities regardless of their capital size.

2. Tier B is a pawnshop with more than 10 offices and a minimum capital of PhP 1 million (US\$21,027). It can engage in corollary business activities with the exception of remittances.
3. Tier C is a pawnshop with more than 10 offices and a minimum capital of PhP 10 million (US\$210,265). It can engage in all corollary business activities including remittances.
4. Tier D is a virtual pawnshop operator engaged in a pawnshop business through the use of virtual technology. The minimum capital requirement is PhP 10 million (US\$210,265).

The proposed regulations set aside the Prudential Capital Ratio requirement and instead introduce a limit on borrowings that a pawnshop business may incur to fund its lending operations. Expressed as a percentage of total borrowings to pledge loans, the borrowings may not exceed 50 percent.<sup>112</sup> The number of creditors that a pawnshop may borrow from (at any one time) is limited to 19.<sup>113</sup>

In the area of financial integrity, the proposed regulations reinforce and expand on previous provisions on customer identification, disclosure of a pawnshop's beneficial ownership, required AML/CFT training for pawnshop staff and AML/CFT Prevention Program in place, and minimum internal control standards (including records safekeeping and retention and insurance). Although the draft regulations allow one person to own several pawnshops, BSP must be notified of the arrangement. Together with improved disclosure of beneficial ownership, this will address BSP's intention to consolidate pawnshops that belong to the same owners because

BSP will consider pawnshops owned by the same person as one pawnshop network (and can enforce consolidation if necessary).

Under a Memorandum of Agreement with the Department of Interior and Local Government, BSP has been cooperating with local government units that issue business permits in their respective municipalities. There is a plan to strengthen this coordination to ensure that all pawnshops are legal<sup>114</sup> (integrity concern) and do not provide services that they are not authorized to offer (protection concern).

The proposed consumer protection regulations refer to the Truth in Lending Act (2012) and prescribe detailed instructions for pawnshop operations, pawn ticket formats, a requirement of a 90-day grace period for pawners to redeem the pawn, and loan terms and conditions disclosure, including the requirement to disclose effective interest rates. In particular, the proposed regulations prescribe the minimum number of pawnshops' business days and hours and require that pawnshops have clearly visible signs. A pawnshop can terminate its activity only if there is notarized evidence of redeemed and sold pawns. The draft regulations reconfirm the minimum loan-to-pawned-item-value ratio of 30 percent. They also reference the Financial Consumer Protection Framework of the BSP (2014), "which is to be adopted insofar as it is applicable to the pawnshops' operations."

#### **b. Which linkages were identified and managed?**

The main objective of the proposed regulations is to consolidate the pawnshop

<sup>112</sup> Borrowings for purposes of acquiring fixed assets to be used for business operations are not included in the limit.

<sup>113</sup> Borrowing from more than 19 lenders requires a quasi-banking license from BSP.

<sup>114</sup> Pawnshops found illegally operating may be sanctioned by local government units (e.g., closure of premises) and/or legal cases may be filed by BSP.

sector. Consolidation would provide a better picture of the market and enable BSP to introduce network-based supervision. After consolidation, BSP would start implementing a risk-based approach to supervision by initially focusing on larger market players and those that are deemed systemically important. Although increasing the minimum capital requirement tends to be used to achieve greater stability, in this instance it is also used as a tool to ration the number of market players to allow for a more efficient supervision and enforcement of regulations—particularly those covering AML/CFT and consumer protection requirements. (Pawnshops do not pose direct risks to systemic stability because they do not mobilize public deposits.) Through sector consolidation, BSP also expects to achieve the objectives of increased financial integrity and consumer protection, as there will be fewer large pawnshops that would be more transparent in terms of their ownership and transactions, and capable of providing better customer service.

**Linkages between stability and inclusion.** BSP understands that implementing a tiered system in the pawnshop sector and the resulting consolidation of the market players will bring significantly reduce the total number of pawnshops. BSP expects to supervise about one-third of the current number of registered pawnshops—i.e., about 5,600 instead of 16,100. While most of the remaining 10,500 pawnshops will become branches of other pawnshops, an estimated 4,000 small pawnshops will need to either join larger networks or increase their capitalization to be able to offer more than just basic services (i.e., engage in corollary activities). BSP is confident that this significant change in the number of pawnshops will not negatively affect financial inclusion in the long term for the majority of the pawnshop customers, especially since the

top 20 pawnshops already cover about 75 percent of the market share (even though in the short term, the effect will be negative).

Limiting borrowings and the maximum number of creditors a pawnshop may borrow from (at any one time) to 19 will restrict the amount of funds pawnshops will be able to borrow for on-lending. These measures are explicitly aimed at limiting the potential for credit intermediation by pawnshops. While this potentially limits financial inclusion in terms of lending volumes, in reality this should not affect the leverage of pawnshops significantly since pawnshops have not been highly leveraged financial institutions anyway (their ratio of total borrowings to total assets between 2009–2013 is 25 percent or less).

**Linkages between stability and integrity.** BSP believes that larger pawnshops formed as a result of the branch consolidation will be able to better conform to AML/CFT requirements as it will be relatively less costly for them. For example, pawnshops are required to keep their records for at least five years on pawnshop premises. However, smaller pawnshops have difficulty meeting these requirements, and reporting on covered and suspicious transactions represents a cost—although pawnshops have yet to incur these costs since almost none has begun to report.

**Linkages between stability and protection.** Bigger pawnshop networks will have better capacity to expand operations and provide sustained services compared to smaller or stand-alone pawnshops, thus benefitting customers over the long term.

**Linkages between integrity and inclusion.** As mentioned in the analysis of the other policy cases (Sections 3.1–3.4), KYC requirements represent a challenge for all financial services providers in the Philippines.

**Linkages between integrity and protection.** Market consolidation will benefit consumers because it will help them to identify pawnshops that belong to the same network. Improved clarity of pawnshop ownership will also help BSP better enforce consumer protection requirements.

**Linkages between protection and inclusion.** BSP efforts at strengthening consumer protection will increase operating costs of the pawnshops. Such costs would include general compliance with the new regulations, including the BSP Consumer Protection Framework, which will require pawnshops to set up Consumer Protection Risk Management Systems commensurate to the size and complexity of their operations. Pawnshops' internal audit functions will also be required to incorporate a Consumer Protection Audit Program.<sup>115</sup> BSP acknowledges the risk that not all pawnshops will be able to meet these requirements right away, but at the same time BSP is consciously taking a proactive approach at improving the quality of financial inclusion before consumer protection challenges reach significant scale.

### c. What are the expected effects on the I-SIP objectives?

**Inclusion.** The number of pawnshop branches is expected to decrease by about 4,000 (roughly 25 percent),<sup>116</sup> with remittance offerings concentrated in only large pawnshops. This will have a negative effect on financial inclusion in terms of the number of financial services providers in the short term. (Note that BSP deliberately left room for the entrance of smaller players in the market by preserving the original minimum capital requirement of

PhP 100,000 (US\$2,103) for the lowest tier of pawnshops.) This is evidence of a balancing act that BSP has been doing to manage the tensions between financial inclusion and other policy objectives.

**Stability.** The pawnshop market consolidation triggered by higher capital requirements will help to strengthen the financial system. Moving from supervision of individual pawnshops to the network supervision approach will improve the quality of BSP supervision and will have a positive effect on stability. As before, pawnshops will not be allowed to intermediate funds from the public and will not be able to have other multiple creditors (although since pawnshops have not been highly leveraged, this appears to be a preventive measure with a neutral effect on stability).

**Integrity.** The effect on integrity is expected to be positive because pawnshops will become more transparent in terms of ownership and related parties' risk assessment. Having higher-risk remittance services concentrated in large pawnshops will make it easier for BSP and the Anti-Money Laundering Council to supervise and monitor these activities.

**Protection.** The effect on protection is expected to be positive because larger, stronger, and more transparent pawnshops will be able to serve customers better. Larger provider networks are especially good for the remittance business, but the economies of scale may positively affect the lending business as well, because increased pawnshop efficiency could lead to lower service costs for customers. Through the planned enhanced cooperation with local government units, BSP expects to have much fewer instances of fraud and fly-by-night

<sup>115</sup> BSP Circular 857, 21 November 2014.

<sup>116</sup> The number of head offices is expected to decrease by about 65 percent (from 16,300 to 5,600).

pawnshops. Including pawnshops in the comprehensive Financial Consumer Protection Framework will help to harmonize consumer protection regulation across financial services providers.

**d. What have we learned about managing linkages and optimizing results?**

**Definitions.** The national definition of “financial inclusion” in the Philippines includes two qualitative dimensions: the quality of inclusion as such and customer well-being. This definition helped to guide policy makers as they decided on the need to significantly reduce the number of market players. Limiting the number of pawnshops—besides achieving the goal of having fewer but larger and stronger institutions—is also expected to improve their transparency, concentrate higher-risk activities within larger players (integrity), and increase efficiency and quality of service (consumer protection). This will eventually improve the quality of financial inclusion and lessen the supervisory burden on BSP, leading to better supervision of pawnshops.

**Structured approach.** The draft pawnshops regulations are an example of a proactive and proportionate approach of the regulator aimed at addressing stability, integrity, and consumer protection concerns before they reach significant scale.

**Inter- and intra-agency collaboration.** BSP has been collaborating with local government units, the SEC, and the Anti-Money Laundering Council to develop the draft regulations.

**Data.** Collecting comprehensive data on all aspects of pawnshop operations has been challenging because of the large number of pawnshops and limited supervisory capacity of BSP. BSP used a practical approach of combining existing data on pawnshops activities with findings from the inspection of 600 pawnshops to produce a comprehensive set of draft regulations that address major risks.

**Consultations with providers.** BSP has been consulting with the Pawnbrokers’ Association to get its feedback on proposed regulations.

**Policy adaptation.** BSP regulations on pawnshops since 1973, including the draft regulations of 2015, are an example of a constant and conscious effort by policy makers to optimize the linkages among the I-SIP objectives in view of the changing environment and emerging risks. However, because of the large number of market players, the process of market consolidation may take some time. BSP may want to consider certain transitional provisions governing the consolidation process because it may not have the capacity needed to enforce the regulations instantaneously.

The fact that the activities of international remittance companies that have many pawnshops as their agents are not regulated and supervised by BSP creates regulatory arbitrage with respect to enforcing national AML/CFT requirements. Also, as noted, the absence of a national ID system presents a challenge for all financial services providers, and this cannot be resolved through regulations on individual market players.

## 3.6 Summary of Linkages in Policy Interventions

TABLE 5. Summary of Linkages in Policy Interventions

Policy intervention	Policy change	Primary motivation	Trade-off policy makers were concerned about	Observed effects to date
<b>Mandated agricultural credit</b>	Presidential Decree No. 717 on mandated agricultural credit (1975, as amended by Republic Act No. 10000 or the Agrarian Reform Credit Act of 2009).	Inclusion and access to credit by agrarian reform beneficiaries.	Stability (risk mitigating mechanisms). Protection (focus on vulnerable customers). Integrity (relaxed KYC).	Neutral on inclusion. Negative on stability (financial position of banks and impact of over-indebtedness, limited risk mitigation mechanisms). Positive on integrity. Possibly neutral on protection (formerly excluded consumers benefit from banking consumer protection rules, but over-indebtedness risk associated with no credit history information and high interest rates).
<b>National Strategy for Microfinance</b>	The National Strategy for Microfinance (1997) and related laws and regulations.	Inclusion and stability: increase the role of private sector, promote market-oriented financial and credit policies, eliminate participation of ineffective government programs.	Stability (improve sustainability and efficiency in the financial sector). Protection considered, though not explicitly (promoting competition in the market).	Positive on inclusion. Possibly neutral on stability (better performance of banks with microfinance, but no prudential supervision of quasi-deposit taking nonbanks). Possibly neutral on protection (lower microfinance interest rates compared to informal market, but no enforcement of consumer protection regulations as other MFIs (NGOs and co-ops) are not supervised by BSP).

<b>E-money guidance</b>	BSP Circular 649: Guidelines governing the issuance of electronic money and the operations of electronic money issuers in the Philippines (2009).	Inclusion: part of BSP's goal of promoting the "availability and acceptance of e-money as a retail payment medium."	Stability (quasi-banking license for EMIs), integrity (relaxed KYC), protection (e-money explicitly defined as a nondeposit).	Effect on inclusion is positive but lower than expected. Positive on stability and integrity. Neutral on protection.
<b>Regulations on Microbanking offices</b>	BSP Circular 694 allowing the establishment of microbanking offices (2010).	Inclusion: promote and maximize the delivery of efficient and competitive banking services to underserved markets and customers.	Stability (prudential and internal control requirements and maximum onsite cash limit) and integrity (relaxed KYC).	Positive effect on inclusion, integrity, and protection. Neutral on stability.
<b>Draft regulations on pawnshops</b>	Development of new regulations on pawnshops introducing four tiers of pawnshops and expanded AML/CFT and consumer protection requirements (2015).	Stability, integrity, protection: consolidation of the pawnshop sector to allow for more efficient supervision and enforcement of regulations and better quality customer service.	Inclusion (reduction in the number of pawnshop branches by about 25 percent).	Ex-ante: Positive for stability, integrity, and protection (smaller number of stronger, more stable, and more transparent pawnshops). Negative on inclusion in the short term, but positive in the longer term as the quality of inclusion will be improved.

## 4. OBSERVATIONS ON THE PHILIPPINES I-SIP AND NEXT STEPS

The Philippines is the fourth country in which the I-SIP research exercise took place (after South Africa, Pakistan, and Russia). This section summarizes observations from the five Philippine cases that are relevant for other countries as they work to advance financial inclusion and offers suggestions for next steps in developing and refining the I-SIP Approach. Some of the observations are case-specific and cannot necessarily be generalized, and are likely to apply only in cases that share some of the characteristics with one or more of the five policy interventions analyzed in the Philippines.

### 4.1. Observations vis-à-vis the I-SIP Propositions

**Proposition 1. Clear definitions:** *Clear definitions for each of the I-SIP objectives at the national level and at the level of specific policy interventions are needed to guide policy makers in policy design. The definitions at the policy intervention level should be detailed enough to allow for measuring the effects of the intervention with regard to I-SIP objectives.*

**Over the course of the past two decades, BSP has developed a comprehensive vision for financial inclusion that takes into account other policy objectives, such as financial stability, financial consumer protection, and financial integrity.** This vision has culminated in the development of the National Strategy for Financial Inclusion (Section 2). In its policy-making efforts, BSP has shown an awareness of the four I-SIP objectives that are defined in BSP's regulations and other documents (Box 3).

**BSP awareness of the linkages between the I-SIP objectives has been**

**progressing over time**—from the lack of consideration of the linkages in the Agri-Agra law (Section 3.1) to primarily addressing the inclusion-stability linkage in the National Strategy for Microfinance (Section 3.2) and to attention to linkages between all four I-SIP objectives in newer policy interventions—E-money guidance (Section 3.3), regulations on microbanking offices (Section 3.4), and draft regulations on pawnshops (Section 3.5).

**The national definition of financial inclusion emphasizes the quality dimension of financial services in addition to quantitative measures of access and usage. It facilitates policy decisions involving the reduction in the number of weak market players, leading over time to an improved quality of financial inclusion.** An example of this is the case of draft regulations on pawnshops (Section 3.5). Besides the goal of having fewer but larger and stronger pawnshops, the proposed pawnshop regulations are expected to improve pawnshops' transparency and concentrate higher-risk activities within larger players (addressing the integrity objective) and improve efficiency and service quality (consumer protection objective). This is expected to eventually improve the quality of financial inclusion and reduce the supervisory burden on BSP resulting in better supervision of the existing institutions.

**Older policy interventions aimed at expanding financial access could be revised using the new definition and vision for financial inclusion.** An obvious candidate for such revision is the law on mandated agricultural credit—the Agri-Agra Reform Credit Act (Section 3.1), though it will likely entail political difficulties as explained further. The particular complexities of

### BOX 3. I-SIP definitions in the Philippines

**Financial inclusion:** “Financial inclusion is a state wherein there is effective access to a wide range of financial services by all. [. . .] ‘Effective access’ does not only mean that there are financial products and services that are available but also encompasses four broader components . . . [**access, usage, quality, welfare**]. Aside from physical access to financial products and services, these products and services must be appropriately designed, of good quality, and relevant to lead to actual usage that can benefit the person accessing the said service. ‘Wide range of financial products and services’ refers to a full suite of basic products and services for different market segments, particularly those that are traditionally unserved and underserved.”<sup>a</sup>

**Financial stability:** “. . . is a situation when the governance framework of the market and its financial infrastructure enable and ensure the smooth functioning of the financial system conducive to sustainable and equitable economic growth.”<sup>b</sup>

**Financial integrity:** “It is hereby declared the policy of the State to protect and preserve the integrity and confidentiality of bank accounts and to ensure that the Philippines shall not be used as a money laundering site for the proceeds of any unlawful activity. Consistent with its foreign policy, the State shall extend cooperation in transnational investigations and prosecutions of persons involved in money laundering activities wherever committed.”<sup>c</sup>

**Financial consumer protection:** “Consumer protection pertains to measures that promote the rights of clients, enable them to make informed choices and protect them from unscrupulous acts that deny them the true value and optimum benefits of microfinance services such as credit, deposits/savings, insurance, and remittances and transfers.”<sup>d</sup>

“The Financial Consumer Protection Framework enumerates basic principles and ethical business practices that govern the conduct of BSP-supervised financial institutions in dealing with their consumers, [. . .] sets out minimum standards in the areas of disclosure and transparency, protection of client information, fair treatment, effective recourse and financial education, [. . .] underscores that financial consumer protection is a fundamental part of financial institutions’ corporate governance and culture.”<sup>e</sup>

a. National Strategy for Financial Inclusion, 1 July 2015. <http://www.bsp.gov.ph/downloads/publications/2015/PhilippinesNSFIBooklet.pdf>

b. Working definition developed by the BSP Financial Stability Committee.

c. Republic Act No. 9160. Anti-Money Laundering Act of 2001, 29 September 2001. [http://www.bsp.gov.ph/regulations/laws\\_aml.asp](http://www.bsp.gov.ph/regulations/laws_aml.asp) (amended by Republic Act No. 9194, 7 March 2003 and No. 10167, 18 Jun 2012).

d. Microfinance Consumer Protection Guidebook. National Credit Council, 2007. <http://www.bu.edu/bucflp/files/2012/01/Microfinance-Consumer-Protection-Guidebook.pdf>

e. BSP Circular No. 857. 21 November 2014. <http://www.bsp.gov.ph/downloads/regulations/attachments/2014/c857.pdf>

agricultural credit policies from economic, social, and political standpoints require policy makers to monitor their results much more closely and be able to revise policies if they are not

effectively addressing agricultural sector problems—or if they worsen or create new problems. Because BSP requires banks to report on compliance with the requirements of the Agri-Agra law, the

data from these reports could allow BSP to start a quantitative assessment of the effects of this policy intervention on financial inclusion, stability, integrity, and consumer protection. Such a review could also help to identify data not currently collected but that should be so that the effectiveness of this policy can be evaluated and a deeper consideration of the effects of the Agri-Agra law on other policy objectives can be determined. More importantly, the review should consider policy approaches, other than mandated credit, that address root causes of the nondelivery of financial services to the agricultural sector: for example, the inadequacy of existing guarantee systems, lack of other credit risk transfer mechanisms, and costs/difficulties of acquiring prospective borrower information and credit risk analysis.

**While in the case of the Philippines there are general definitions of the I-SIP objectives, it is necessary to translate them into specific objectives and measurable targets pertaining to concrete policy interventions and to establish respective indicators—including baseline figures—against which to monitor progress.** In many instances during the analysis of the five policy cases, specific targets were not established, and the data were insufficient to support definitive conclusions on the effectiveness of policy interventions. As noted, there are limited data on financial services providers outside of the supervisory perimeter of BSP (Section 3.1). Yet even in the case of BSP-supervised institutions, there are often no baseline data, or not enough granularity in the data, to allow progress in achieving the I-SIP objectives to be tracked.

***Proposition 2. Structured approach:***  
*A structured approach to identifying material linkages among I-SIP objectives that may arise in the implementation of a specific policy*

*intervention helps to manage and optimize linkages, thereby avoiding false or unnecessary trade-offs between objectives and maximizing synergies among them.*

**The Philippines I-SIP exercise reaffirmed the usefulness of following a systematic approach as proposed by the six I-SIP Propositions.** Where the steps proposed by the I-SIP Propositions were followed, whether intentionally or not, more positive effects on all four I-SIP objectives could be observed. In the cases where some of the I-SIP Propositions had not been considered, it was more difficult for policy makers to use a proportionate approach to regulation and supervision of financial-sector actors (Section 3.6).

**The institutionalization of financial-sector reform agendas provides a strong foundation for systematic policy-making processes, including designing and revising policies and measuring policy results. This is where the I-SIP Approach can be integrated.** The structured consultative process undertaken by policy makers in the process of developing the National Strategy for Microfinance became a standard for policy making in the Philippines. The National Strategy for Microfinance was the first strategy of its kind in the Philippines. It was such a success that it institutionalized the process for subsequent national financial inclusion policy reforms in the Philippines. For example, the National Strategy for Microinsurance of January 2010 and the more recent National Strategy for Financial Inclusion approved in July 2015 were designed following the same consultative policy-formulation process as was used for the National Strategy for Microfinance (Section 3.2).

These formalized processes and associated multi-stakeholder coordination and implementation bodies facilitated

the integration of the I-SIP Approach into regular policy making, as a mechanism that could be used by both such coordination platforms and the individual entities involved in policy making.

***Proposition 3. Collaboration:*** *Inter- and intra-agency collaboration is critical to design, monitor, and adapt policy interventions to optimize the linkages among I-SIP objectives, as well as linkages with national objectives beyond the I-SIP objectives.*

**The Philippines I-SIP research exercise confirmed that expanding financial inclusion is a long-term endeavor that requires broad-based participation and sustained and focused efforts by several stakeholders—recognizing that the challenges go beyond the financial system regulators.**

While significant progress has been achieved after almost two decades of focused financial inclusion efforts, there is still much to be done for the Philippines to reach the levels of financial inclusion characteristic of more developed countries and of some of the Philippines' peers in the East Asia and the Pacific region and lower middle-income countries (Section 2). Microfinance NGOs and financial cooperatives under the oversight of the SEC and CDA, respectively (see Section 3.2 and Annex 2), have been providing financial services to low-income and unbanked people over the past decades, even before banks ventured into microfinance. While the 1997 National Strategy for Microfinance (and subsequent regulatory framework) clarified government policy and the roles of these nonbank MFI regulators, these regulators have had limited capacity and resources to set relevant targets and monitor and measure progress, as compared to BSP. The new shared and comprehensive vision for financial inclusion, defined under the 2015 National Strategy for Financial Inclusion, is expected to address these challenges by clearly

stating the development path. Financial inclusion is now among the priorities of the regulatory and supervisory bodies in charge of financial services providers outside BSP's supervision and other government agencies charged with key inclusion-related initiatives. The National Strategy for Financial Inclusion, as a collaborative platform, also provides opportunities for capacity building and coordinated progress measurement and monitoring.

The role of donors has been crucial in supporting the National Credit Council and BSP in elaborating the National Strategy for Microfinance and in supporting the industry overall (Section 3.2). Among that factors that contribute to the success of donor support is the responsiveness and alignment of donor interventions with national policy makers' priorities and objectives, which has formed a strong foundation for collaboration and the deepened levels of commitment to pursue shared policy objectives. As noted, donors were able to ensure the independence and objectivity that were necessary to pinpoint the issues facing the microfinance sector.

***Proposition 4. Regular data:*** *Regularly collected and analyzed data based on indicators and targets specific to a given policy intervention enable the monitoring of its effects on the I-SIP objectives and the management of linkages over time.*

**The data-gathering process should be systematic because data are at the core of measuring linkages.** For example, the "data versus dogma" approach was crucial for the implementation of the National Strategy for Microfinance, where a team of technical experts from the National Credit Council meticulously reviewed all the directed credit programs and highlighted the poor impact of these programs to justify the reform

(Section 3.2). At the same time, while the reform itself was well supported by data and studies, the approach did not permeate further policy implementation. The post-reform data are inadequate and fragmented, thus limiting the conclusive assessment of I-SIP linkages and the overall effectiveness of National Strategy for Microfinance.

**Third-party involvement proved useful for objective data collection and analysis.** The studies and data gathering for the National Strategy for Microfinance were funded by USAID, which ensured the involvement of technical experts and impartial third-party perspectives (Section 3.2). Objective market research and data analysis efforts are key to understanding the needs of the agricultural sector in the Philippines. They will also help stakeholders to determine whether increased credit supply—a synonym for financial inclusion under the government-led approach before the 1997 Strategy—is indeed a solution or whether other aspects of financial inclusion should be promoted (e.g., insurance and savings), or other measures would be necessary (e.g., infrastructure building or value-chain creation and support) (Section 3.1).

**In the absence of comprehensive data, a practical approach to data gathering and analysis (such as sampling methodologies) can provide a basis for decision-making.** For example, with respect to pawnshops, collecting comprehensive data on all aspects of their operations has been challenging because there are so many of them and BSP has limited supervisory capacity. In this situation, BSP used the practical approach of combining existing database information on pawnshops' activities with findings of the inspection of 600 pawnshops to create a comprehensive set of draft regulations that address major risks (Section 3.5). (This approach, however, does not eliminate the need to

collect the necessary data on pawnshops' operations from now on to evaluate the effect of the draft regulations.)

**To ensure effective policy making using the I-SIP Approach, it is important to identify potential linkages among I-SIP objectives at the onset of regulations** and to exercise intentional measurement of these linkages through institutionalized data and reporting requirements in the course enforcing the regulation. For example, in the case of microbanking offices regulations, better availability of outreach data and analysis of loan portfolio quality could have helped to appreciate the inclusion—stability linkage (Section 3.4).

***Proposition 5. Consultation with providers:** Periodic structured consultation with providers in proportion to the scale of the proposed policy changes helps to identify and manage linkages as the market develops.*

**To better identify financial inclusion targets, it may be necessary to have more active consultation with providers to better understand provider practices and potential consumer protection risks stemming from these practices.** For example, the growth of e-money uptake has not been at the rate regulators had hoped. Factors influencing the uptake include the lack of interoperability among e-money issuers and confusion among customers created by provider business practices, such as a perception that e-money can expire (because of provider dormancy charges). In the eyes of consumers, e-money is a complicated product that they do not fully understand—unlike, for example, pawnshops, which provide similar payment and remittance services, are well known to low-income customers, and seem more accessible because of their widespread physical presence as compared to a more limited e-money agent network. Moreover, e-money providers

know that it is a challenge to offer consistent quality of customer experience across all touch points and to provide a user-friendly interface. As a result, the potential of e-money as a gateway to basic financial services for the unbanked has not been fully realized (Section 3.3).

**Proposition 6. Policy adaptation:** *Optimization of I-SIP linkages requires a commitment by policy makers to manage the I-SIP linkages by adapting policy and regulation as necessary in light of the data and other evidence collected and effects observed.*

**The nature of policy interventions could determine how flexible policy makers can be in adapting the policies.** For example, the fact that very few revisions have been made to the Agri-Agra framework shows the challenges of adapting these types of government interventions to changes in the financial and economic landscape. The inability of policy makers to manage the negative inclusion-stability linkage seems to arise from the mandatory nature of the law itself, aggravated by the lack of adequate information on the target market, which heightens costs/risk perception of banks in lending to the agricultural sector (Section 3.1). Agri-Agra is linked to the broader policy objective of “enhancing access of the rural agricultural sector to financial services and programs that increase market efficiency and promote modernization in the rural agricultural sector.” This illustrates that policy objectives beyond I-SIP may shape the decision-making of policy makers. Agri-Agra is a concrete example of the possible negative outcomes if I-SIP objectives are not carefully considered in financial inclusion policy making. This highlights the importance of identifying and managing I-SIP linkages whenever a financial inclusion policy is being proposed or amended.

By contrast, BSP regulations on pawnshops in support of the Pawnshop Regulation Act that dates back to the same time as the old Agri-Agra framework (1973) have been subject to continuous adaptation. This illustrates a constant and conscious attempt by BSP to optimize the linkages among the I-SIP objectives in view of a changing environment and emerging risks (Section 3.5), supported by the necessary policy maker flexibility in performing these adaptations.

**A more pronounced risk-based, well-coordinated, and market-wide approach to regulating and supervising the various big and small financial sector players will be necessary to mitigate financial stability, integrity, and consumer protection risks, to ensure a level playing field, and to avoid regulatory arbitrage opportunities.** This includes the different regulatory and supervisory treatment of nonbank financial institutions such as microfinance NGOs and financial cooperatives—many of which are engaged in some form of financial intermediation (Section 3.2).

**The absence of a national ID system presents a KYC challenge for all financial services providers; thus the potential trade-off between financial inclusion and integrity cannot be easily resolved unless KYC policies are further adapted.** The acceptance of alternative forms of identification for lower-risk products and the loosening of KYC requirements have been helpful, but not sufficient to facilitate expanding financial inclusion into unserved and underserved population segments. Some rigidities remain, such as the requirements for any form of ID to bear a photo, or for providers to carry out face-to-face KYC and to keep paper-based documentation (Sections 3.1–3.5). The issue is likely to continue affecting financial inclusion efforts in the Philippines.

## 4.2. Next Steps

**The I-SIP exercise in the Philippines marks a turning point in the development and application of the I-SIP Approach. It provides an opportunity to differentiate between I-SIP research and the application of the I-SIP Approach.** Conceived as a pilot study in South Africa, the I-SIP Approach aims to shed light on whether and how policy makers balance financial inclusion with other policy objectives. The underlying assumption was that increased financial inclusion could result in a positive (or at least no negative) impact on financial stability, integrity, and protection. The four I-SIP exercises conducted have consistently shown that financial inclusion, stability, integrity, and consumer protection can be positively related (under the right circumstances), and that failing to consider any one of these objectives can lead to problems. The four exercises led to the development of the I-SIP Propositions to guide future policy making.

To collect evidence for the study, CGAP applied the I-SIP research methodology using quantitative and qualitative (sometimes referred to as “soft”) data, such as information collected through interviews with key stakeholders. While the I-SIP research method has been useful for the externally guided I-SIP research teams that have carried out all four I-SIP exercises, this one-time exercise may not be an optimal way for

regular policy analysis by national policy makers because it does not provide sufficient guidance and tools for policy makers who want to apply the I-SIP Approach on their own.

The following next steps could better position policy makers to apply the I-SIP Approach:

- **The purpose of the I-SIP Approach should be clearly communicated to stakeholders who are working to advance financial inclusion.** Deeper understanding of the need to balance financial inclusion with the other policy objectives of stability, integrity, and protection is a precursor to integrating the I-SIP Approach into policy making.
- **Hands-on tools are needed to help policy makers identify what should be done to integrate the I-SIP Approach into policy making and to use it to assess the effectiveness of policy interventions or their expected impact.** A guiding document that explains both the I-SIP research (the preparation stages, the steps to carry out data and information collection, and suggestions on integrating these into regular processes) and the I-SIP Approach to policy making (explaining how to do each part of the analysis on a regular basis)<sup>117</sup> could help national policy makers to apply the I-SIP Approach without external support.

117 Including, potentially, guidance for third-party and peer reviews.

## ANNEX 1. INTERVIEWS

Organization	Name	Position/Department
Agricultural Credit Policy Council	Ms. Magdalena Casuga	
Agricultural Guarantee Fund Pool	Ms. Edna Atienza	Executive Director
Anti-Money Laundering Council Secretariat	Atty. Ruel Bumatay	Handling National Risk Assessment and amendments to Implementing Rules and Regulations of the AML Act
	Atty. Sheila Gebilaguin	Handling National Risk Assessment Working Group on Financial Inclusion
	Atty. Robert Bernardo	Compliance Group
Bankers Association of the Philippines	Ms. Pinky Padronia	Senior Associate
	Mr. Arnel Almaden	Senior Associate
BPI-Globe-BanKo	Mr. John Rubio	President
BSP	Mr. Nestor Espenilla, Jr.	Deputy Governor, Supervision and Examination Sector
	Ms. Pia Bernadette Roman Tayag	Director, Inclusive Finance Advocacy Staff
	Ms. Rochelle Tomas	Inclusive Finance Advocacy Staff
	Mr. Mynard Bryan Mojica	Inclusive Finance Advocacy Staff
	Ms. Mary Ann Cuevas	Inclusive Finance Advocacy Staff
	Atty. Florabelle Santos-Madrid	Director, Anti-Money Laundering Specialist Group
	Mr. Heinz Ryan Espinosa	Anti-Money Laundering Specialist Group
	Dr. Johnny Noe Ravalo	Assistant Governor, Financial Supervision Research and Consumer Protection Sub-Sector and Head, BSP Agri-Agra Task Force
	Ms. Judith Sungsai	Director, Office of Supervisory and Policy Development and Member, BSP Agri-Agra Task Force
	Mr. Vicente De Villa III	Director, Supervisory Data Center
	Ms. Christine Bunyi	Officer-in-Charge, Central Point of Contact Department I and Member, BSP Agri-Agra Task Force
	Ms. Cynthia Sison	Deputy Director, Office of Supervisory and Policy Development and Secretariat, BSP Agri-Agra Task Force

(Continued)

Organization	Name	Position/Department
BSP	Mr. Gerardo Butardo	Director, Human Resource Management Department, and original member, MBO Task Force
	Ms. Belinda Caraan	Director, Central Point of Contact Department IV
	Ms. Concepcion Garcia	Original member, MBO Task Force
	Ms. Ma. Luisa Nieva	Original member, MBO Task Force
	Ms. Chuchi G. Fonacier	Managing Director, Supervision and Examination Sub-Sector II
	Mr. Abelardo Laya	Officer-in-Charge, Integrated Supervision Department I
	Ms. Luida Vinluan	Manager, Integrated Supervision Department I
	Mr. Joseph Joanino	Integrated Supervision Department I and Member, Task Force on Pawnshop Regulation Amendments
	Mr. Jayson Sari	Integrated Supervision Department I and Member, Task Force on Pawnshop Regulation Amendments
	Mr. Raymond Estioko	Deputy Director, Office of the Deputy Governor, Supervision and Examination Sector (former Core Information Technology Specialist Group head)
	Ms. Maria Emelia Cube	Manager, Core Information Technology Specialist Group
	Atty. Rhio Fuentes-Nuylan	Acting Deputy Director, Supervision and Examination Sector Technical Services Staff
	Atty. Bridget Rose Medina-Romero	Supervision and Examination Sector Technical Services Staff
	Mr. Eduardo Jimenez	BSP Microfinance Consultant (also a former member of MCPI Board, and currently working with an NGO MFI (KMBI))
	Mr. Rino Zerna	Officer-in-Charge, MSME Finance Specialist Group
	Ms. May Monteras	MSME Finance Specialist Group
Atty. Prudence Angelita Kasala	Director, Financial Consumer Protection Department	
Bureau of Agrarian Reform Development	Ms. Catalina Austria	
CARD institutions	Dr. Aristotle Alip	Managing Director, CARD-Mutually Reinforcing Institutions
	Ms. Dolores Torres	President, CARD Bank (rural bank)
	Ms. Mary Jane Perreras	President CARD SME Bank (thrift bank)

Organization	Name	Position/Department
Cebuana Lhuiller	Mr. Jose Miguel Jimenez	Head of Pawnshop Operations
	Ms. Rose Freno	
Chamber of Pawnbrokers of the Philippines, Inc.	Atty. Pablo B. Magno	Legal Counsel
Chamber of Thrift Banks	Ms. Suzanne Felix	Executive Director
Cooperative Development Authority	Ms. Fe Caingles	Director
	Mr. Jun Defensor	Manager
Department of Agriculture	Mr. Antonio Fleta	Undersecretary
Department of Finance/National Credit Council	Mr. Gil Beltran	Undersecretary, DOF and Executive Director, National Credit Council
Department of Trade and Industry	Ms. Lilian Salonga	Assistant Director, Consumer Protection Group
	Mr. Homer Bunyi	Trade Industry Development Specialist
E-PESO Activity	Mr. John Owens	Chief of Party
Globe Xchange Inc (G-cash)	Mr. Xavier Marzan	President, G-cash
	Mr. DN Santos	G-cash
Land Bank of the Philippines	Ms. Jocelyn Cabreza	Branch Banking Sector
	Ms. Gliceria Angeles	Program Officer, Lending Program Management Group
	Mr. Randolph Montesa	Card and e-Banking Group
Legaspi Savings Bank	Mr. Mykel Abad	President
Microfinance Council of the Philippines Inc.	Ms. Ma. Anna Ignacio	Chairman, MCPI Board of Trustees and CEO of Kasagana Ka Development Center (NGO MFI)
	Mr. Allan Sicat	Executive Director
	Ms. Mercy Abad	President, Ahon sa Hiras Inc. (NGO MFI), former head
	Ms. Mila Mercado-Bunker	Former chair
Maria Gracia Pawnshop Inc.	Mr. Ryan Paguntalan	Corporate Affairs Manager
	Ms. Cynthia Macapagal	
	Mr. Sonny Juanico	
National Confederation of Cooperatives	Ms. Sylvia Paraguya	CEO
National Consumer Affairs Council	Mr. Jose Pepito	Chairman
	Ms. Velma Lim	Former Executive Director

Organization	Name	Position/Department
National Telecommunications Commission	Mr. Edgardo Cabarrios	Head for Regulation
	Ms. Marle F. Rabena	Chief of Services and Interconnection Division
OmniPay	Mr. Simoun Ung	President
Peoples Credit and Finance Corporation	Mr. Edgardo Generoso	President
	Mr. Dominador Pantalita	Corporate Affairs
Philippine Crop Insurance Corporation	Mr. Norman Cajucom	Senior Vice President
	Mr. Allan Retamar	
Philippine Deposit Insurance Corporation	Ms. Cristina Orbeta	President
	Ms. Sandra Diaz	Associate Vice President
	Mr. Jun Villaret	
	Mr. Chris Suguitan	
Producers Savings Bank	Mr. Edmundo Medrano	President
Rizal Commercial Banking Corporation	Ms. Sylvia Roxas	Card Group
	Ms. Froila Morales	Card Group
Robinsons Bank Corporation	Mr. Andro Yee	Senior Vice President and Head of Community Banking
Rural Bankers Association of the Philippines	Mr. Vicente Mendoza	Executive Director
Securities and Exchange Commission	Ms. Teresita Herbosa	Chairperson
	Atty. Justina Callangan	Director
The World Bank	Ms. Nataliya Mylenko	Senior Financial Sector Specialist, Finance & Markets Global Practice
USAID	Ms. Tess Espenilla	
	Dr. Gilbert Llanto	Consultant, Former Chief of Party, USAID Credit Policy Improvement Program (CPIP) that supported creation of National Strategy
	Dr. Ma. Piedad Geron	Consultant, Former Deputy Chief of Party, USAID CPIP

## ANNEX 2. FINANCIAL SERVICES ACCESS POINTS IN THE PHILIPPINES

### BSP Supervised Access Points

#### Bank

A bank refers to an entity engaged in lending funds obtained in the form of deposits. Banks are moneyed institutes founded to facilitate the borrowing, lending, and safe-keeping of money and to deal in notes, bills of exchange, and credits.

Source: Bangko Sentral ng Pilipinas (BSP) [2011] Banking Laws of the Philippines (Book I): The General Banking Law Annotated. Manila.

#### Automated Teller Machine

An automated teller machine (ATM) shall refer to a computerized telecommunications device that provides clients of a financial institution with access to financial transactions in a public place. It is a machine that dispenses cash with the use of an ATM card.

Source: International Monetary Fund, Financial Access Survey (<http://data.worldbank.org/indicator/FB.ATM.TOTL.P5>)

#### Nonstock Savings and Loan Association (Nssla)

A nonstock savings and loan association is a nonstock, nonprofit corporation engaged in the business of accumulating the savings of an exclusive group of persons who make capital contributions to the association, and using such for loans to members to service the needs of households by providing long-term financing for home building and development and for personal finance.

Sources: Bangko Sentral ng Pilipinas (BSP) [2011] Banking Laws of the Philippines (Book III): Special Banking Laws Annotated. Manila.

Manual of Regulations for Non-bank Financial Institutions (MORNBF), § 4101S (2013).

#### Pawnshop

A duly organized and licensed pawnshop has the power to engage in the business of lending money on the security of personal property within the framework and limitations of Presidential Decree No. 114, subject to the regulatory and supervisory powers of the BSP. It is synonymous to pawnbroker or pawnbrokerage.

Sources: P. D. No. 114, Section 3, (1973); MORNBF, § 4101P.2 (2013)

#### Remittance Agent

Remittance agents shall refer to persons or entities that offer to remit, transfer, or transmit money on behalf of any person to another person and/or entity. These include money or cash couriers, money transmission agents, remittance companies, and the like.

Source: MORNBF, § 4511N.1 (2013)

#### Money Changer/Foreign Exchange Dealer

Money changers, interchangeably referred to as foreign exchange dealers, shall refer to those regularly engaged in the business of buying and/or selling foreign currencies.

Source: MORNBF, § 4511N.1 (2013)

#### E-Money Agent

A person or business that is contracted to facilitate transactions for users. The most important of these are cash-in and cash-out (i.e., loading value into the mobile money system, and then converting it back out again); in many instances, agents register new customers, too. Agents usually earn commissions for performing these services.

Source: GSMA (2010). Mobile Money Definitions

## Non-BSP Supervised Access Points

### Cooperative

A cooperative is an autonomous and duly registered association of persons, with a common bond of interest, who have voluntarily joined together to achieve their social, economic, and cultural needs and aspirations by making equitable contributions to the capital required, patronizing their products and services and accepting a fair share of the risks and benefits of the undertaking in accordance with universally accepted cooperative principles. Cooperatives are the supervision of the Cooperative Development Authority.

Source: RA 9520 (Philippine Cooperative Code of 2008)

### Microfinance NGO

Microfinance NGOs register with the SEC as a nonstock, nonprofit organization. Almost all of them collect forced savings (sometimes referred to as capital build-up) from their borrower-clients. Since they are not supposed to take deposits from their clients, they are not subject to prudential regulations.

Source: Regulatory Framework for Microfinance in the Philippines

### Lending Investor/Company

Lending Company (synonymous with lending investor) shall refer to a corporation engaged in granting loans from its own capital funds or from funds sourced from not more than 19 persons. It shall not be deemed to include banking institutions, investment houses, savings and loan associations, financing companies,

pawnshops, insurance companies, cooperatives and other credit institutions already regulated by law. Lending companies/investors are under the SEC.

Source: RA 9474 (Lending Company Regulation Act of 2007)

### Financing Company

Financing companies are corporations, except banks, investments houses, savings and loan associations, insurance companies, cooperatives, and other financial institutions organized or operating under other special laws, which are primarily organized for the purpose of extending credit facilities to consumers and to industrial, commercial, or agricultural enterprises, by direct lending or by discounting or factoring commercial papers or accounts receivable, or by buying and selling contracts, leases, chattel mortgages, or other evidence of indebtedness, or by financial leasing of movable and immovable property. Financing companies/investors are under the SEC.

Source: RA 8556 (Financing Company Act of 1998)

### Insurance Agent

Any person who for compensation solicits or obtains insurance on behalf of any insurance company or transmits for a person other than himself an application for a policy or contract of insurance to or from such company or offers or assumes to act in the negotiating of such insurance shall be an insurance agent. Insurance agents and companies are supervised by the Insurance Commission.

Source: RA 10607 (The Insurance Code)

**Number of access points**

Services Offered	Access Point	2014	2015	Growth
Full service	Banks	10,315	10,710	3.8%
Savings, credit, and other services	Nonstock savings and loan associations	199	200	0.5%
	Credit cooperatives <sup>a</sup>	2,822	3,202	13.5%
	MFI NGOs <sup>b</sup>	1,812	2,190	20.9%
Credit and other services	Pawnshops	17,422	17,238	-1.1%
	Other NBFIs <sup>c</sup>	137	163	19.0%
Payments, remittance and other services	Remittance agents, money change/foreign exchange dealers	10,478	10,666	1.8%
	E-money agents <sup>d</sup>	10,620	13,435	26.5%
	ATMs	15,692	17,314	10.3%

a. 2013 vs. 2014 (2015 data not yet available). Data from the CDA as of end-year 2013 (latest available) showed that there are 7,247 cooperatives offering financial services (savings and credit) out of 10,675 reporting cooperatives.

b. 2013 vs. 2014 (2015 data not yet available). Data are based only from a sample of microfinance NGOs. In 2014, 16 microfinance NGOs responded to BSP's request for data.

c. Other NBFIs include lending investors, financing companies, credit card companies, investment companies, securities dealers/brokers, government NBFIs, and credit granting entities (excluding microfinance NGOs) that are supervised by the BSP.

d. 2013 vs. 2014 (2015 data not yet available). These are active agents. The count includes pawnshops, remittance agents, and money changer/foreign exchange dealers that also serve as e-money partner outlets.

## REFERENCES

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