



Progress Report on Tranche Release

Program Number: 38579-01
Loan Number: 2199
November 2007

Philippines: Microfinance Development Program

CURRENCY EQUIVALENTS

(as of 30 October 2007)

Currency Unit	–	Peso (P)
P1.00	=	\$0.0229
\$1.00	=	P43.73

ABBREVIATIONS

ADB	–	Asian Development Bank
AFMA	–	Agriculture and Fisheries Modernization Act
AMCFP	–	Agriculture Modernization Credit and Financing Program
BDS	–	business development service
BIR	–	Bureau of Internal Revenue
BMBE	–	barangay microbusiness enterprise
BSP	–	Bangko Sentral ng Pilipinas
CDA	–	Cooperative Development Authority
CGAP	–	Consultative Group to Assist the Poor
CISTG	–	Core Information Technology Supervisory Group
COOP	–	compliance with administrative and legal requirements, organization operations and governance, and plans and programs
DBP	–	Development Bank of the Philippines
DOF	–	Department of Finance
DSWD	–	Department of Social Welfare and Development
DTI	–	Department of Trade and Industry
EA	–	executing agency
EO	–	executive order
GFI	–	government financial institution
GIS	–	general information sheet
GNFA	–	government nonfinancial agency
GSIS	–	Government Service Insurance System
IT	–	information technology
JFPR	–	Japan Fund for Poverty Reduction
KAPAKANAN	–	Kakayahan, Pagtitiwala, Aksyon at Puhunan
LBP	–	Land Bank of the Philippines
MCPI	–	Microfinance Council of the Philippines
MDG	–	Millennium Development Goal
MDP	–	Microfinance Development Program
MFI	–	microfinance institution
MRR	–	Manual of Rules and Regulations
NAPC	–	National Anti-Poverty Commission
NCC	–	National Credit Council
NGO	–	nongovernment organization
NLSF	–	National Livelihood Support Fund
PCFC	–	Peoples' Credit and Finance Corporation
PCNC	–	Philippine Council of NGOs Certification
PESO	–	portfolio quality, efficiency, sustainability, and outreach
PMO	–	Privatization and Management Office
PMU	–	program management unit
PPSB	–	Philippine Postal Savings Bank
RA	–	republic act

SCA	–	standard chart of accounts
SEC	–	Securities and Exchange Commission
TA	–	technical assistance

NOTES

- (i) The fiscal year (FY) of the Government and its agencies ends on 31 December.
- (ii) In this report, "\$" refers to US dollars.

Vice President	C. Lawrence Greenwood, Jr., Operations Group 2
Director General	A. Thapan, Southeast Asia Department (SERD)
Director	J. Ahmed, Governance, Finance and Trade Division, SERD
Team leader	E. Sasaki, Financial Sector Specialist, SERD
Team members	B. Nguyen, Finance Specialist (Rural and Microfinance), SERD R. O’Sullivan, Senior Counsel, OGC

CONTENTS

	Page
I. INTRODUCTION	1
II. MACROECONOMIC AND MICROFINANCE SECTOR DEVELOPMENT	1
A. Macroeconomic Developments	1
B. Microfinance Sector	3
C. Government Strategy for Microfinance Sector Development	3
D. Sector Development	4
E. Asian Development Bank's Development Experience	5
III. STATUS OF SECOND TRANCHE RELEASE POLICY ACTIONS	6
A. Policy and Regulatory Component	6
B. MFI Capacity Building Component	8
C. Regulatory Capacity Building Component	9
D. Financial Literacy and Consumer Protection Component	10
IV. PROGRAM IMPLEMENTATION	11
A. MDP TA and JFPR Grant Assistance	11
B. Recent Developments	12
V. CONCLUSION	13
VI. THE PRESIDENT'S DECISION	14
APPENDIXES	
1. Design and Monitoring Framework	15
2. Status of Compliance with Second Tranche Policy Actions	21
3. Recent Policy Developments	29

I. INTRODUCTION

1. On 22 November 2005, the Asian Development Bank (ADB) approved a \$150 million loan and a \$0.5 million technical assistance (TA) grant for the Microfinance Development Program (MDP).¹ The MDP is expected to improve household incomes, reduce poverty, and lessen the vulnerability of the poor. It aims to help achieve the Millennium Development Goals (MDGs), including the eradication of extreme poverty and hunger, and promote gender equality and empowerment of women. The MDP is aligned with the G8 action plan for poverty reduction, best practices of the Consultative Group to Assist the Poor (CGAP), and ADB's microfinance development strategy. ADB also approved a grant financed by the Japan Fund for Poverty Reduction (JFPR) for the development of microfinance operating cooperatives² to help the Government implement an MDP component covering capacity building of the cooperative sector.

2. The MDP was formulated to further develop microfinance through strategic reforms in four areas: (i) enhancing the enabling policy and regulatory environment, and removing regulatory impediments and policy distortions, to promote market efficiencies and increased outreach of services at competitive prices to the poor; (ii) building viable microfinance institutions (MFIs) that can deliver retail services to the poor efficiently and cost-effectively; (iii) strengthening regulatory and supervisory capacities and oversight for a sound microfinance sector; and (iv) increasing financial literacy and consumer protection for the poor and users of microfinance services. The design and monitoring framework is in Appendix 1.

3. The Department of Finance (DOF), the Executing Agency (EA) for the MDP, provides overall guidance for project implementation and coordinates with the following implementing agencies: Bangko Sentral ng Pilipinas (BSP), Bureau of Internal Revenue (BIR), Cooperative Development Authority (CDA), National Anti-Poverty Commission (NAPC), Philippine Postal Savings Bank (PPSB), and the Securities and Exchange Commission (SEC). NAPC is the oversight body established under the Social Reform and Poverty Alleviation Act (Republic Act [RA] 8425) for the development of microfinance as a potent tool for poverty reduction. The National Credit Council (NCC), the body for formulating and implementing financing policy under Administrative Order No. 86 of 1993, has been nominated by the secretary of finance to be the program management unit (PMU). In that role, NCC is to oversee implementation of the program and coordinate activities among the implementing agencies.

4. The MDP calls for policy actions in these four areas supported by the \$150 million loan, which is to be disbursed in two equal tranches. The first tranche was released on 15 December 2005 upon loan effectiveness following the Government's compliance with the first tranche policy actions. The second tranche is expected to be released by the end of the program period (end of December 2007) upon compliance with the agreed-upon policy actions.

¹ ADB. 2005. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan and Technical Assistance Grant to the Republic of the Philippines for the Microfinance Development Program*. Manila.

² ADB. 2006. *Grant Assistance Philippines: Developing Financial Cooperatives Project (Financed by the Japan Fund for Poverty Reduction)*. Manila (approved on 14 March 2006).

II. MACROECONOMIC AND MICROFINANCE SECTOR DEVELOPMENTS

A. Macroeconomic Developments

5. In 2006, the Philippines' gross domestic product (GDP) grew at 5.4%. The economy's performance in the first half of 2007 exceeded market expectations by a wide margin, growing at 7.3%. This included 7.5% growth in the second quarter, the fastest GDP expansion in 20 years. In response, most analysts have raised their full-year growth targets for the Philippines, with the consensus at 6.1%–6.7% for 2007.³ The Philippines is experiencing its longest economic expansion in 30 years (i.e., growth above 5% for 5 years).

6. Solid growth in personal consumption, higher government expenditures, and a jump in net exports contributed to the better-than-expected GDP numbers. Personal consumption, which accounts for more than three quarters of GDP, grew by 6.0% in the first half of 2007, underpinned by an 18.1% increase in recorded remittances from overseas workers to \$7.0 billion. An 11.8% rise in Government consumption, which accounts for a relatively modest share of the economy, was a smaller factor. Public sector construction rose steeply, and investments in durable equipment rebounded to a positive 0.5% growth rate in the first half of 2007. Overall investment increased by almost 5% in the first semester.

7. Economic growth was broad-based, with all major sectors contributing. Services recorded particularly strong growth at 8.6%. Retail trade, the largest services subsector, expanded at a robust 8.7%, reflecting strong consumer demand. Other major subsectors, such as finance, transport, and communication, also grew strongly. The business process outsourcing industry remained strong. Agricultural production, which was damaged by typhoons late last year, recovered to grow 4.0% in the first half of 2007. Construction, mainly in the public sector, and mining also were solid performers. Public sector construction jumped by 33.8% in the first half (compared with 20.3% growth in the year-earlier period), while private sector construction grew by 8.5% (compared with a 3.6% contraction a year earlier). Mining output, which grew by 24.3% in the first half, benefited from increased participation of foreign investors and high prices for base and precious metals. Gold prices hit a 27-year high.

8. Some evidence suggests that the Philippine economy has had a structural break from the boom–bust cycles of the past. First, staff estimates indicate that productivity growth has become a significant source of economic growth since 2000, averaging at least 1.7% per year. This compares with almost zero productivity growth in the 1990s and negative growth in the 1980s. Microeconomic reforms implemented since the 1990s explain part of the structural change in the economy. Second, remittances have increased and appear to be resilient. Tentative evidence suggests that remittance flows are beginning to fuel investment in the property sector rather than just consumption.

9. Inflation decelerated faster than anticipated to 2.6% in the first half of 2007, compared with 7.1% during the first half of 2006. Inflation remained stable in July (2.6%) and August (2.4%). Prices of food staples have been relatively stable, and the impact of the 2 percentage point increase in the value-added tax early in 2006 has been absorbed. The peso's continued appreciation also helped to tame inflation. Although a dry spell and rising oil prices may have some impact on inflation during the second half of the year, the full-year inflation prediction has been lowered to 2.9% from 4.8% in *Asian Development Outlook 2007*.

³ The *Asian Development Outlook* forecast for 2007 GDP growth has been revised from 5.4% to 6.6%.

10. Fiscal consolidation, the centerpiece of the Government's economic reform program, remains on track. The national Government deficit is estimated to fall below 1% of GDP this year, and the consolidated public sector budget is in surplus, exceeding expectations. Tax revenues have grown by 6.4% in the first 8 months of 2007, short of its 14% target. Government non-interest expenditures rose by 24% in the year to August, with large increases in public infrastructure spending. Interest payments have fallen by 13% due to the peso's appreciation, lower interest rates, and prepayments of commercial debt.

11. In summary, although some risks remain, the prospects for the country remain positive. The structural changes and implementation of the government's reform agenda have enabled the country to stay on a positive growth track. As long as the government remains focused on maintaining this momentum, the virtuous cycle is likely to continue and strengthen the Philippines' prospects for sustainable growth.

B. Microfinance Sector

12. Microfinance is the viable and sustainable provision of a broad range of financial services (savings, credit, insurance, remittance, and transfers) with an emphasis on the poor and low-income households engaged in livelihood and microenterprise activities. Nontraditional and innovative methodologies and approaches are applied to microfinance, including net cash flow-based lending, close monitoring of borrowers' activities, and unique forms of security (e.g., group liability). In the Philippines, by the BSP definition, individual microfinance loans do not exceed P150,000. Loan maturities are typically 6 months or less, with frequent repayments (e.g., weekly, semimonthly, or monthly basis). Microfinance loans are provided to individuals or groups. More than 90% of borrowers are women.

13. Rural and thrift banks, cooperatives, and nongovernment organizations (NGOs) provide microfinance services at the retail level, while commercial banks and government financial institutions (GFIs) provide funds on a wholesale basis. The People's Credit and Finance Corporation (PCFC)⁴ plays a major role as a wholesaler of funds to retail MFIs. PCFC provides market-based loans to MFIs, currently at 12% per year. MFI interest rates to clients are high, normally more than 40% per year, reflecting high costs associated with labor-intensive operations. Repayment rates are good—usually more than 95%—due to an intensive process of client selection using means tests and frequent loan monitoring. Good portfolio quality together with high profitability has attracted an increasing number of new service providers to the sector in recent years.

14. The regulatory and supervisory bodies of MFIs are BSP for banks; CDA for savings and credit cooperatives, and multipurpose cooperatives; and SEC for NGO MFIs. The National Credit Council (NCC), established in 1993 through Administrative Order No. 86, comprises representatives from DOF, BSP, SEC, CDA, GFIs, government-owned and -controlled corporations, and private sector organizations. NCC looks at policy issues on all government credit programs and their implementation, playing a major role in microfinance development policy formulation and implementation.

⁴ PCFC is the leading wholesale lending institution in microfinance with a total of P9 billion in cumulative loans released to the sector. It is a government-owned finance company established in 1997 as part of the Government's social reform agenda. PCFC has a capital of P1 billion funded by the National Livelihood Support Fund, a national fund supervised by Land Bank of the Philippines.

C. Government Strategy for Microfinance Sector Development

15. The government recognizes microfinance as an important tool for reducing poverty. This is articulated clearly in the Medium-Term Philippine Development Plan 2004–2010. The specific policies and strategies to be pursued for the effective delivery of microfinance services are spelled out in the National Strategy for Microfinance, released in 1997. The government's microfinance policy is built on the following principles:

- (i) Greater role for private MFIs in the provision of financial services.
- (ii) An enabling policy environment that will facilitate the increased participation of the private sector in microfinance.
- (iii) Market-oriented financial and credit policies, e.g., market-oriented interest rates on loans and deposits.
- (iv) Non-participation of government line agencies in the implementation of credit and guarantee programs.

16. Executive Order No. 138 (EO 138), issued in 1999, reaffirmed the market principles applied to the microfinance policy, mandating the abolition of subsidized, government-directed credit programs and transfer of all government-directed credit programs to GFIs. It also prohibited government nonfinancial agencies (GNFAs) from implementing government credit programs, and limited the government's role to providing the appropriate and enabling policy environment to encourage greater private sector participation in the delivery of credit services to the basic sector⁵.

D. Sector Development

17. Government policy directions, based on market principles, have helped increase the number of private institutions engaged in the provision of microfinance services. As of June 2007, MFIs including branches totaled 2,188. Active microfinance clients nearly doubled from 1.4 million in June 2004 to 2.7 million in June 2007. During the same period, the number of new jobs created totaled 1.3 million. Table 1 shows growth of the Philippine microfinance sector.

Table 1: Growth of the Philippine Microfinance Sector

		June 2004	June 2007
Client Outreach	Active Clients	1,439,423	2,788,050
	Number of Jobs Generated	—	1,254,151
3-year Cumulative Loan Releases (P billion)		(July 2001– June 2004)	(July 2004– June 2007)
	Active Clients	9.8	69.88
	Jobs Generated	—	33.72

Source: Microfinance Program Committee

⁵ Basic Sectors refer to the disadvantaged sectors of Philippine society, namely: farmer-peasant, artisanal fisherfolk, workers in the formal sector and migrant workers, workers in the informal sector, indigenous peoples and cultural communities, women, differently-abled persons, senior citizens, victims of calamities and disasters, youth and students, children, and urban poor.

18. As of December 2006, BSP figures show 212 banks offered with microfinance services, reaching 650,104 clients with an outstanding portfolio of P4.1 billion. Of these banks, eight are microfinance-oriented banks with more than 50% of their portfolio dedicated to microfinance. Three major NGO MFIs—CARD, TSPI, and TSKI—collectively increased their active clients more than 10-fold over 6 years, from 44,413 at the end of 2000 to 475,045 at the end of 2006.⁶ The current depth of outreach is a positive sign, but the potential for future development remains huge. Overall market penetration is as low as 20%–25% (footnote 6), with more than two thirds of poor households (14 million people) still lacking access to microfinance services.

19. As the industry expands, appropriate supervision and regulation of MFIs are becoming more important to ensure that the risks associated with microfinance are minimized and appropriately managed by the concerned MFIs. The continued viability and sustainability of these institutions is important for microfinance to contribute effectively to poverty reduction.

20. Cellular phone technology has been used to provide microfinance services, facilitating money transfer, bills payment, and purchase from a store with e-wallet. Through the issuance of several circulars, BSP has supported the promotion of electronic banking, setting the rules and regulations for risk management, consumer protection against fraud, and prevention of money laundering. As of March 2007, 87 banks offered electronic banking functions, including 43 rural and cooperative rural banks. The increase in the number of rural and cooperative rural banks with electronic banking services will increase access to financial services in the countryside.

E. Asian Development Bank's Development Experience

21. ADB supported the Government in establishing an efficient wholesale microfinance institution, PCFC, which provides loans to retail MFIs for market-based microcredit operations, and strengthening MFI institution through the Rural Microenterprise Finance Projects.⁷ ADB TA supported the MFI capacity building and increase in social mobilization through (i) field survey to assess microfinance access and demand in frontier areas, (ii) training to selected NGO MFIs in good practices for sustainable microfinance, and (iii) educating the poor to increase their knowledge and understanding of microfinance services.⁸

22. The MDP was formulated based on the following lessons learned from ADB's microfinance operations:

- (i) The market-based approach is the key to maximizing development impact. This approach emphasizes an enabling policy environment, financial infrastructure, and strengthened financial intermediaries.
- (ii) Microfinance clients are more concerned about access to services that meet their requirements than about the cost of services.

⁶ Fernando, A. Nimal. 2007. *Low-Income Households' Access to Financial Services: International Experience, measures for Improvement and the Future*. Manila: ADB.

⁷ ADB. 1996. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan and Technical Assistance Grant to the Republic of the Philippines for the Rural Microenterprise Finance Project*. Manila (approved on 23 April 1996 for \$20,000,000, funded by the Asian Development Fund).

⁸ ADB. 2004. *Technical Assistance to the Republic of the Philippines for Enhancing Access of the Poor to Microfinance Services in Frontier Areas*. Manila (approved on 23 December 2004 for \$250,000, funded by the Governance Cooperation Fund).

- (iii) Strong retail institutions committed to outreach and sustainability are essential for permanently extending the reach of financial services and significantly affecting poverty reduction.
- (iv) The demand for savings services by poor households and microenterprises is as strong as the demand for credit. Expanding the outreach of savings services can significantly enhance institutional sustainability and poverty reduction.
- (v) Financial education is necessary to introduce the poor to a formal market-oriented institutional environment.

III. STATUS OF SECOND TRANCHE RELEASE POLICY ACTIONS

23. Since MDP implementation started, the Government has made a steady progress in substantively complying with the second tranche release policy actions in the four key areas. Accordingly, the 24 second tranche release policy actions have been complied with. Appendix 2 shows the status of the Government's compliance with the second tranche release policy actions.

A. Policy and Regulatory Component

1. Philippine Declaration on Microfinance

24. Under the policy and regulatory component, the Government has been monitoring progress of initiatives and commitments under the Philippine Declaration on Microfinance to promote microfinance as an effective tool for reducing poverty. The Government has been collaborating with the banking community, cooperatives, NGOs, and the donor community. As of February 2007, the number of PCFC conduits reached 202, up from 199 at the end of December 2005, with about 2 million clients and approved loans totaling P6.5 billion. According to reports by NAPC and the Microfinance Program Committee,⁹ the number of active microfinance clients reached 3.1 million as of August 2007, with loan releases totaling P75.0 billion. The number of MFIs, including branches, has reached 2,188.

2. Expansion of Bank Branching

25. In January 2000, the General Banking Act was enacted recognizing the peculiar characteristics of microfinance in formulating rules and regulations for banks with microfinance operations.¹⁰ On 22 December 2005, BSP issued Circular No. 505 allowing microfinance-oriented banks and branches to set up branches anywhere in the country, subject to meeting the criteria and standards. BSP has promoted the development of sound and sustainable microfinance in the banking sector through the issuance of regulations. By the end of 2006, 91 new branches, including microfinance-oriented bank branches, had been approved.

⁹ Microfinance Program Committee comprises government financial institutions providing wholesale funds for microfinance lending, i.e., PCFC, Land Bank of the Philippines, Development Bank of the Philippines, and Small Business Guarantee and Finance Corporation.

¹⁰ Peculiar characteristics of microfinance include noncollateral-based lending, weekly collection of repayment and interest payments, and close monitoring of borrowers' business activities through weekly meetings.

3. Promoting E-Banking

26. BSP also has promoted electronic banking to facilitate electronic payment transactions and value transfers, including remittances to MFIs, by establishing the Core Information Technology Supervisory Group¹¹ in June 2005 and issuing circulars in 2006. BSP Circular No. 542, entitled Consumer Protection for Electronic Banking, prescribes the rules and regulations for consumer protection. It aims to (i) better safeguard consumer information, especially from fraud and theft; (ii) promote legal enforceability of banks' electronic agreements and transactions; and (iii) prevent money laundering and terrorist financing. Circular No. 511, entitled Guidelines on Technology Risk Management, also was issued to ensure that banks have the necessary skills, knowledge, and capacity to understand and effectively manage technology-related risks. These actions have further institutionalized BSP's responsiveness to electronic banking and information technology developments within the banking sector. As of March 2007, 87 banks (43 rural and cooperative rural banks, 11 thrift banks, and 33 commercial and universal banks) had applied and been approved to offer e-banking products. The expansion of e-banking, including the application of cellular phone technology to financial transactions, is expected to lower the cost of transfers and payments, and promote savings mobilization for MFIs to expand services at a lower cost of funds.

4. Truth in Lending

27. DOF, in collaboration with CDA, completed six public consultations and 12 regional consultations on the draft *Manual of Rules and Regulations* (MRR) in 2006. The MRR provides the guidelines for microfinance-operating cooperatives for complying with the provisions of CDA regulations on sound microfinance operations. Cooperative federations and unions, local governments, GFIs, and CDA regulators also can consult the MRR for improved regulatory compliance and supervision. The MRR includes guidelines on truth-in-lending disclosures to ensure compliance of cooperatives. Moreover, NAPC has issued an industry advisory on requirements under the Borrower's Truth-in-Lending Law and truth-in-lending disclosures to borrowers¹² to familiarize microfinance sector stakeholders with truth-in-lending disclosure requirements. The industry advisory has been posted on NAPC's website (www.napc.gov.ph/microfinance.htm) and widely distributed to stakeholders.

5. Disclosure of MFIs

28. SEC laid a foundation for supervising NGOs providing microfinance and other related financial services by issuing two memorandum circulars. On 18 January 2006, SEC issued Memorandum Circular No. 2 on microfinance operations of NGOs, which requires NGOs providing microfinance and related services to disclose this information to SEC. Within 30 days of its issuance, NGOs were required to file a revised general information sheet (GIS) and, if necessary, amended articles of incorporation. SEC also issued Memorandum Circular No. 9, dated 29 June 2006, requiring all domestic non-stock corporations, including NGOs, to use the revised GIS form. The new form includes an area for marking if a company is engaged in microfinance. NAPC maintains and develops the database on MFIs, and publishes data on its website and in its annual reports. CDA has completed phase 1 of the CDA project to establish a database for public and internal access on savings and credit cooperatives. This is the first step

¹¹ Core Information Technology Supervisory Group is responsible for issuing information technology (IT) risk policies, providing baseline IT risk standards, and aligning policies with international best practices.

¹² NAPC Microfinance Industry Advisory, Disclosure of Financial Charges in the Provision of Loans/Credit. Issued 21 November 2005.

toward greater transparency and disclosure of savings and credit cooperatives providing microfinance services, and public access to such information.

6. Clarifying Taxation on MFIs

29. In May 2006, BSP and DOF-NCC conducted a seminar on microfinance for key BIR personnel to assist them in formulating an appropriate revenue regulation to clarify taxation on different types of MFIs. After a series of internal and external discussions, BIR identified the imposition of corporate income tax on NGOs engaged in microfinance operations as the central issue. BIR has drafted a regulation clarifying taxation on microfinance-operating NGOs after consulting with the Philippine Council of NGOs Certification (PCNC). This regulation, applicable to NGO MFIs, was recommended by the BIR Commissioner for approval by the Secretary of Finance. It was approved and issued in December 2007.

B. MFI Capacity Building Component

1. MFI Performance Standard

30. Under the MFI capacity building component, performance standards adopting NCC requirements have been established in government regulatory agencies, GFIs, and rural bank and MFI associations.¹³ The sets of performance standards applicable to different types of MFIs, i.e., banks, cooperatives, and NGOs, are based on international best practices in evaluating financial institutions engaged in microfinance. Basic training sessions for CDA Board and management have been conducted. This was followed by a seminar on good governance for the CDA Board, and advanced intensive training program for CDA management and personnel on the standard chart of accounts (SCA),¹⁴ CDA performance standard (COOP-PESO) requirements, and the MRR. These sessions helped strengthen CDA's oversight capacity for better compliance of savings and credit cooperatives with the CDA regulatory requirements.

2. Strengthening MFI Institutional Capacities

31. In February 2006, DOF and CDA jointly conducted six public hearings on the draft MRR for savings and credit cooperatives. The draft included (i) requirements for minimum fit and proper standards for the board directors and key management; (ii) training for officers and directors; and (iii) internal management systems, including mandatory committees. Under Article 3: Management, the MRR requires setting up several commissions: audit; credit; election; training and membership; and ethics, mediation, and conciliation. The CDA Board approved the MRR in February 2007; it was issued upon the approval of the President of the Philippines in October 2007. CDA issued a resolution approving a proposal for the inspection of cooperatives, including the requirement for collection of credit information on microfinance clients for the credit information system. CDA plans to issue unique cooperative identification numbers to existing and verified operating cooperatives for effective collection of credit information.

¹³ Performance standards adopting NCC requirements include the capital adequacy, asset quality, management, earnings, liquidity, and sensitivity to market risk rating (adopted by BSP); the portfolio quality, efficiency, sustainability, and outreach (PESO) rating (adopted by LBP, PCFC, and Microfinance Council of the Philippines); the compliance to administrative and legal requirements, organization, operations and governance, and plans and programs-PESO (adopted by CDA); and the equity, asset, growth, liability, and earning rating (adopted by Rural Bankers' Association).

¹⁴ Standard chart of accounts was updated in June 2007 in response to the latest International Accounting Standards requirements.

3. Promoting Business Development Services

32. Assisted by the MDP TA, NAPC issued guidelines and a model business development services (BDS) manual to promote BDS for the poor to improve their livelihood and microenterprise performance. NAPC was supported by the Department of Trade and Industry (DTI), Department of Science and Technology, Technology Resource Center, Technical Education and Skills Development Authority, NCC, and BSP. Focus group discussions on the provision of BDS were conducted among key officers and staff of MFIs, and among MFI clients, during February–March 2007. The discussions focused on (i) strategies undertaken by MFIs in providing BDS, (ii) client demand for BDS, and (iii) good practices employed by providers. Based on the results of these discussions, NAPC issued an industry advisory containing guidelines and best practices in providing BDS, which was widely distributed to stakeholders. The advisory was posted on the NAPC website on 22 October 2007.

4. Promoting Best Practices in Microfinance Services

33. Also with the TA inputs, NAPC issued an industry advisory to promote sustainable microfinance schemes, including lending, savings, and insurance schemes for sound expansion of microfinance services. Focus group discussions on microfinance schemes, including micro-savings and micro-insurance were conducted among key officers and staff of MFIs. The discussions focused on identifying practices adopted by MFIs, and whether these practices complied with existing regulations and policies. Based on the results of the discussions, NAPC issued an industry advisory promoting best microfinance practices, including micro-savings and micro-insurance, on 22 October 2007.

5. Privatization Options for PPSB

34. MDP calls for financial assessment and valuation of PPSB to formulate privatization options and plans with the aim of increasing efficiency and outreach of PPSB operations in rural areas. These activities originally were within the scope of the MDP TA project. Instead, the DOF Privatization and Management Office (PMO) has undertaken them, with assistance from its financial advisor. The financial advisor worked based on the latest financial reports of PPSB. PMO submitted the privatization options and action plans for PPSB, including the financial assessment and valuation, to the PPSB board of directors who discussed them on 9 October 2007 at the board meeting.

C. Regulatory Capacity Building Component

1. CDA Reorganization

35. Under the component on strengthening regulatory and supervisory capacities, CDA submitted to DOF a proposed rationalization plan on 30 March 2006. It includes a CDA reorganization plan to strengthen its regulatory oversight of savings and credit cooperatives. It covers, among others, the proposed organizational structure, duties and responsibilities per position, and qualification standards applicable to the selection of CDA officers in monitoring financial performance of savings and credit cooperatives.

2. Regulation for Cooperative Sector

36. EO 332¹⁵ gave DOF the authority to oversee CDA policies and directions. DOF has been providing appropriate guidance to CDA in transforming itself from cooperative promoter to a cooperative regulator in line with the draft amendments for the Cooperative Development Authority Act No. 6939. With the assistance of the MDP TA project, DOF has organized a series of strategic planning workshops for the CDA management to formulate its medium-term strategy for the transformation. The CDA chair, management committee, DOF representatives, and cooperative representatives attended the workshops. The MRR issued in October 2007 requires the adoption of SCA and the performance standards (COOP-PESOS) by savings and credit cooperatives. CDA has been monitoring and advising cooperatives to adopt SCA and the performance standards.

37. The MRR established prudential rules and regulations for savings and credit cooperatives to implement provisions of RA 6938, the Cooperative Development Authority Act, and RA 6939, the Cooperative Code of the Philippines. The MRR also includes a provision on reportorial requirements, including quarterly reporting to CDA on the financial condition and internal maintenance of monthly reports. These sets of information will be incorporated in the cooperative annual performance report, a database information instrument being finalized by CDA, and will be required for annual submission by cooperatives.

3. BSP Adoption of Risk-Based Supervision and Other Regulations for Sound Microfinance Operation by the Banking Sector

38. BSP conducts risk-based supervision for microfinance operations based on Monetary Board Resolution No. 492, dated 14 April 2005. This resolution approved the modification of the capital adequacy, asset quality, management, earnings, liquidity, and sensitivity to market risk rating, as well as amendments to the *Manual of Examination for Banks* to supervise banks with microfinance operations more appropriately and adequately. In 2006, BSP inspected 90 banks with microfinance operations using risk-based supervisory procedures. BSP also has been conducting staff training on risk-based supervision. To date, eight cycles of a 6-week structured training on risk-based supervision have been conducted, with 376 participants from various offices in the supervision and examination sector.

39. BSP, with related circulars¹⁶ being implemented, has ensured implementation of the requirements to set up audit, corporate governance, and risk management committees for safe and sound conduct of business practices. BSP also has ensured conduct of risk management, provision of reserves, implementation of bank controls to determine allowance for probable losses, requirements for external independent auditors, and reporting on internal control and risk management systems for safe and sound banking through the issuance and implementation of relevant circulars.¹⁷ To effectively supervise and examine banks engaged in microfinance operations, the Microfinance Examination Group was created in BSP on 11 August 2006 by virtue of Monetary Board Resolution No. 1012.

¹⁵ EO 332, issued on 16 July 2004, is entitled Transferring Cooperative Development Authority from President Office to Department of Finance.

¹⁶ Circular No.434, dated 18 May 2004; and Circular No.456, dated 4 October 2004.

¹⁷ Circular No.442, dated 20 July 2004; Circular No.463, dated 29 December; Circular No.474, dated 3 February 2005; and Circular No.409 in 2003.

D. Financial Literacy and Consumer Protection Component

1. Financial Literacy

40. Under the financial literacy and consumer protection component, NAPC has formulated the National Financial Literacy Program, including gender training and consumer protection in collaboration with concerned agencies, local governments, and microfinance training institutions. With the assistance of the MDP TA project, the Financial Literacy Program was presented to the technical working group, comprising NCC, NAPC, and MDP TA consultants. After incorporating comments from the working group, the draft was presented to concerned stakeholders for finalization in August 2007. The program involves a series of capacity building activities to improve microfinance clients' knowledge of financial concepts, skills, and attitude to enable them to turn knowledge into behaviors that will result in good financial outcomes for the providers and users of microfinance services. Since the goal of the program is to contribute to clients' good behavior, such as diligent payment of loans, the right use of credit, and the motivation to save, these developments will benefit the clients, as well as increase the viability and sustainability of MFIs. The program was launched on 22 October 2007, followed immediately by implementation activities, which entailed providing training and information nationwide, including in remote areas. NAPC will report on program implementation in its annual report for 2007.

2. Consumer Protection

41. The MDP TA project drafted a consumer protection guidebook, including procedures for filing consumer complaints. It has been validated by concerned agencies and parties: BSP, CDA, DOF, DTI, NAPC, SEC, and basic sector representatives. The guidebook was finalized for publication and launch on 22 October 2007. NAPC has widely distributed the guidebook to stakeholders and posted the book on its website. NAPC also issued a guidebook on its website. On 16 October 2006, BSP established the Consumer Affairs Group through BSP Order No. 892 for (i) consumer assistance and providing banking public with an avenue to seek redress for grievances, (ii) consumer education and information, and (iii) policy initiation for greater consumer protection.

3. Response to Consumer Complaints

42. NAPC's website was developed under the MDP TA project. The TA consultant team identified the requirements for the website. In October 2007, the website began allowing the public to file the complaints online for (i) failure to meet truth-in-lending disclosure requirements, (ii) noncompliance with the Insurance Law, and (iii) other areas as identified by NAPC. NAPC will submit complaints to relevant authorities, and some complaints received will be published annually in NAPC's annual report. Following the issuance of the NAPC industry advisory mandating MFIs to provide insurance services to comply with requirements under the Insurance Law,¹⁸ a new advisory on more specific requirements was issued on 22 October 2007. The advisory also was posted on NAPC's website for public access, while its hard copy was widely distributed to stakeholders.

4. Requirement of Compliance Officers

43. In February 2007, CDA approved the MRR, which includes provisions on the requirements of compliance officers and required transition period for officers to complete

¹⁸ NAPC Microfinance Industry Advisory, Provision of Insurance. Issued 21 November 2005.

training (within 2 years from the effectivity of the manual). It has been forwarded to the secretary of finance for endorsement and then to the President of the Philippines, who approved it on 16 October 2007. The MRR has been distributed to savings and credit cooperatives to encourage compliance with the regulations, and to CDA staff for reference to their supervising cooperatives.

IV. PROGRAM IMPLEMENTATION

A. MDP TA and JFPR Grant Assistance

44. Implementation of the MDP TA project started on 6 October 2006 after it had been approved concurrently with the MDP loan on 22 November 2005. The TA has produced training modules based on the NCC performance standard, and these were disseminated to MFIs through workshops. The training materials and workshops are expected to build viable MFIs that can provide efficient and cost-effective services to the poor, one of the development goals of the MDP. This will be achieved through replication and conduct of the training in-house by the trainers who participated in the workshops. It has also helped NAPC formulate a National Financial Literacy Program and publish guidebooks on consumer protection, good microfinance practices, and various BDS models applicable to microenterprise development. Under the TA, the NAPC website was developed to include standard training program, access to relevant laws, links to microfinance associations, and a function for filing public complaints on MFIs not in compliance with Philippine laws and regulations. With the completion of these TA activities, the Government complied with the corresponding second tranche release conditions under the MDP.

45. The JFPR project was approved on 14 March 2006, and implementation started on 20 July 2006. Component 1 (Building Capacity of Financial Cooperatives) finalized the MRR for savings and credit cooperatives. Under the project, the technical working group, comprising representatives from BSP, CDA, DOF-NCC, JFPR, LBP, and Philippine Deposit Insurance Corporation prepared a supervision and examination manual for savings and credit cooperatives. Based on this manual, CDA regulators will receive advanced intensive training following the ongoing basic regulatory training program. Under Component B (Strengthening the Regulatory Capacity of CDA), software will be developed and hardware requirements identified following an assessment and evaluation of the current reporting system and data collection instruments of CDA. The JFPR project helped the CDA transform itself from the cooperative promoter to the cooperative regulator. It also strengthens CDA's institutional and regulatory capacities. In this connection, it has assisted NCC in organizing a series of workshops for CDA management and board members to formulate a medium-term strategy. The project has facilitated Government compliance with the corresponding second tranche release conditions included in the regulatory capacity building component under the MDP.

B. Recent Developments

46. The repeal of EO 138 in August 2006, commonly regarded as a pillar of the government's market-based financing strategy for the sector, introduced a new element to the sector's policy framework. The EO predates the MDP and does not appear in the policy actions required for tranche release. However, its withdrawal led to a careful staff assessment and discussions with stakeholders to determine the overall impact on the policy environment.¹⁹ EO 138 was replaced by EO 588, which was clarified further in EO 588-A issued on 27 October 2006. EO 588-A focuses on providing microfinance to areas unserved by private sector MFIs. It

¹⁹ A workshop considering the impact of the repeal of EO 138 was held on 4 October 2007 at ADB, attended by 40 participants, including representatives from government agencies, financial institutions, and the private sector.

identifies 47 of the poorest municipalities (the Philippines has 1,510 municipalities), for which P100 million has been allocated. Disbursements remain low because of difficulties of access, inadequate infrastructure, etc., in the identified areas. Appendix 3 provides a detailed assessment of the impact of the withdrawal of EO 138, as well as the progress to date on the special programs initiated under EO 588. Paragraphs 47-50 summarize the findings.

47. EO138 has been perceived as a major element in promoting the sustainable expansion of microfinance in the Philippines. A key feature has been that the lessons learned are being extended to rural and small and medium enterprise finance. This has been supported by a widening array of legislative acts that have extended the applicable scope of market-based principles for finance. These positive developments have deepened the foundations created under EO138 for sustainable, market-driven microfinance. Thus, the philosophy underlying EO138 was incorporated in several sector laws that were enacted before EO138. Thus, the Agricultural and Fisheries Modernization Act phases out directed credit programs for agriculture, and mandates market-based credit policies, with GFIs acting primarily as wholesalers of funds for agriculture. Likewise, the Social Reform and Poverty Alleviation Act adopts market-based interest rates for microfinance, with government funds used primarily for capacity building.

48. Furthermore, and perhaps most importantly, the General Banking Act of 2000 (RA 9478) recognizes the “characteristics of micro financing, such as cash flow-based lending to the basic sectors that are not covered by traditional collateral” in Section 40. This provision mirrors EO 138 in calling for a greater private sector role in providing financial services to the sector, and adoption of market-oriented financial and credit policies. As a consequence of this act, BSP has issued a number of circulars that resulted in more rural and thrift banks providing microfinance services under the provisions of RA 9478. With the passage of the General Banking Act, subsequent legislation has been drafted to conform to its provisions. Thus, section 9 of Barangay Micro Business Enterprise (BMBE) Act of 2002 (RA 9178) also mirrors EO 138 in (i) encouraging private sector participation in the delivery of financial services to microenterprises through the provision of wholesale funds to private financial institutions; and (ii) requiring GFIs to set up special microfinance wholesale credit windows consistent with the policies, rules, and regulations of BSP.²⁰

49. The repeal of EO 138 has engendered a vigorous debate on the subject. For example, at the Philippine Congress a draft House Bill was submitted to formally embed, in a single piece of legislation, all the principles originally contained in EO 138.²¹ To date, these principles, embedded in different legislative acts, provide assurance of the durability of the current microfinance policy. In addition, the commitment to market-based financing for microfinance

²⁰ This section states that “...Upon the approval of this Act, the Land Bank of the Philippines (LBP), the Development Bank of the Philippines (DBP), the Small Business Guarantee and Finance Corporation (SBGFC), and the People’s Credit and Finance Corporation (PCFC) shall set up a special credit window that will service the financing needs of BMBEs registered under this Act consistent with the Banko Sentral ng Pilipinas (BSP) policies; rules and regulations. The Government Service Insurance System (GSIS) and Social Security System (SSS) shall likewise set up a special credit window that will serve the financing needs of their respective members who wish to establish a BMBE. The concerned financial institutions (FIs) encouraged to wholesale the funds to accredited private financial institutions including community-based organizations such as credit, cooperatives, non-government organizations (NGOs) and people’s organizations, which will in turn, directly provide credit support to BMBEs.”

²¹ House Bill No. 5788, entitled An Act Providing a Sustainable Loan Program through a Rationalized Government-Private Sector Financial Services System, and for Other Purposes, was submitted by Representative Teofisto Guingona III in October 2006. After dissolution of Congress, a new House bill on the same objective was being prepared for submission to 2007 Congress in November 2007. A similar bill is being drafted by Senator Benigno Aquino Jr., which will be simultaneously filed in the Senate.

appears strong within government agencies. This is not surprising as the GFIs, BSP, and DOF-NCC have long been implementers of key elements of the EO138 philosophy.

50. The new credit program under EO 558-A is being implemented on a cost recovery basis. It is carefully screening and identifying clients not served by any private sector MFI. The program implementation guidelines stipulate that the operation under the program will be discontinued once a target area starts to receive microfinance service from a private sector MFI. The government has gone on to facilitate the operations of private sector MFIs with its "text an MFI program" through which private MFIs can be located more readily.

V. CONCLUSION

51. The Government has made substantial progress in microfinance sector reform under the MDP. The MDP second tranche release conditions have been fully complied with. The development objectives of the MDP have been met, supported by, among others, (i) expanded microfinance operations nationwide, (ii) the establishment by NCC and CDA of a regulatory framework for savings and credit cooperatives for their sustainable operations, (iii) SEC disclosure requirement to cover NGOs engaged in microfinance, (iv) BIR action for tax clarification on MFIs, (v) BSP promotion of microfinance-oriented banks and e-banking, (vi) risk-based supervision of banks providing microfinance, and (vii) NAPC's implementation of the national financial literacy program.

52. Despite the repeal of EO 138 and its replacement by EO 558, the market principles embodied in the current legislation, and the government actions based on this legislation, appear to be well anchored.

VI. THE PRESIDENT'S DECISION

53. In view of the progress made in the implementation of the Microfinance Development Program, as evidenced by the full compliance with all 24 second tranche release conditions, the President is satisfied with the overall implementation of the Microfinance Development Program, and that the necessary conditions for the release of the second tranche of Microfinance Development Program have now been fulfilled. In accordance with the established procedure, the President will authorize the release of the second tranche in the amount of \$75,000,000. The authorization shall be effective not less than 10 working days after the circulation of this progress report to ADB's Board of Directors.

DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets	Monitoring Mechanisms	Assumptions and Risks
<p>Impact</p> <p>Improved household incomes and reduced poverty and vulnerability of the poor to shocks</p>	<ul style="list-style-type: none"> Increased outreach and access of the poor to sustainable microfinance services as measured by the Consultative Group to Assist the Poor (CGAP) depth of outreach tools and guidelines Increased investment in income-generating activities and microenterprises Improvement in economic lives of the poor 	<ul style="list-style-type: none"> Reports from the National Anti-Poverty Commission (NAPC), Microfinance Council of the Philippines (MCPI), National Credit Council (NCC), Cooperative Development Authority (CDA), and other concerned agencies National statistics and economic and consumption surveys Program reviews Asian Development Bank (ADB) postevaluation report 	<p>Assumptions:</p> <ul style="list-style-type: none"> Government commitment to policy and institutional reforms Macroeconomic stability Active participation of the private sector and the poor Effective social mobilization of the poor and active participation Effective and timely implementation of reforms Satisfactory fiscal management and macroeconomic stability <p>Risks:</p> <ul style="list-style-type: none"> Delays in implementation of reforms Insufficient mobilization of the poor
<p>Outcome</p> <p>A sustainable and diverse, market-oriented microfinance subsector with expanded outreach of services at competitive prices for the poor</p>	<ul style="list-style-type: none"> Microfinance institution (MFI) outreach indicators improved, including increased number of active microfinance clients; and of transactions during 2005–2007 and beyond from 2004 baseline MFI sustainability indicators improved¹ during 2005–2007 and beyond from 2004 baseline Financial services provided other than credit (e.g., savings, microinsurance services, and remittances) Increased savings to gross domestic product ratio and savings mobilization in MFIs 	<ul style="list-style-type: none"> Reports of NAPC, MCPI, NCC, CDA, and other concerned agencies Formally adopted or issued policies, regulations, and amended laws MFI audit reports Department of Finance (DOF) monitoring and reporting on fulfillment of policy actions Progress reports of ADB missions Consultants' reports ADB postevaluation report 	<p>Assumptions:</p> <ul style="list-style-type: none"> Government commitment to policy and institutional reforms Macroeconomic stability Active participation of the private sector and the poor Effective and timely implementation of reforms <p>Risks:</p> <ul style="list-style-type: none"> Delays in implementation of reforms Lack of qualified trainers or institutes for large-scale capacity building and training
<p>Outputs</p> <p>1. Enabling policy, legal, and regulatory framework for microfinance</p>	<p>Philippine Declaration on Microfinance</p>	<ul style="list-style-type: none"> Formally adopted policy and action plans of Government 	<p>Assumptions:</p> <ul style="list-style-type: none"> Sustained Government commitment to policies, strategy, and action

¹ Asian Development Bank. 2003. *Selected Monitoring Indicators for Microfinance Projects*. Manila.

Design Summary	Performance Targets	Monitoring Mechanisms	Assumptions and Risks
<p>2. Sound prudential regulatory and supervisory regime for MFIs and risk-based supervision for microfinance to ensure protection of poor people's money</p> <p>3. Tax regime for microfinance</p>	<ul style="list-style-type: none"> • collaborative action by the Government, banking community, cooperative sector, nongovernment organization sector, and development community to promote sustainable microfinance • policy and regulatory framework adopted for the development of sustainable and efficient microfinance • subsidized, directed credit programs phased out • regulations and guidelines issued to provide greater flexibility in bank branching for financially sound and well-managed banks • truth-in-lending introduced to all MFIs • Guidelines for truth-in-lending disclosures issued by CDA in line with Bangko Sentral ng Pilipinas (BSP) guidelines • Supervision guidelines developed and issued by BSP for risk-based supervision, and BSP conducting risk-based supervision • Prudential rules and regulations developed and issued for savings and credit cooperatives • Regulations, bylaws, guidelines, chart of account, and accounting systems adopted for MFIs • Financial statements published • BIR regulations issued specifying tax treatment of microfinance transactions, and clarifying the tax regime for MFIs and other entities engaged in microfinance transactions and activities 	<ul style="list-style-type: none"> • Implementation progress reports and reports on industry consultations • Monitoring and reporting on fulfillment of policy actions by DOF • BSP reports • Bureau of Internal Revenue (BIR) reports • NAPC free public access website • BSP and CDA published regulations and instructions • BSP supervision and examination manuals for microfinance • Manual of rules and regulations for savings and credit cooperatives • MFI audit reports and financial statements • Progress reports of ADB missions • BIR reports and revenue regulations • Progress reports of ADB missions 	<p>plan</p> <ul style="list-style-type: none"> • Effective and timely implementation of reforms • Active participation of private sector and the poor <p>Risks:</p> <ul style="list-style-type: none"> • Political expediency in offering subsidized, directed, credit programs • Delays in adopting regulations or amendments <p>Assumptions:</p> <ul style="list-style-type: none"> • Government committed to policies and regulations, and effective and timely implementation <p>Risks:</p> <ul style="list-style-type: none"> • Delay in implementation of reforms <p>Assumptions:</p> <ul style="list-style-type: none"> • Effective and timely implementation of policy reforms • Sustained Government commitment to policies, strategy, and action plan

Design Summary	Performance Targets	Monitoring Mechanisms	Assumptions and Risks
			Risks: <ul style="list-style-type: none"> • Vested interest groups resist changes in tax treatment
<p>4. Regulatory framework developed to facilitate low-cost transfer of remittances from Overseas Filipino Workers (OFWs) to MFIs, including those in remote areas, using cell phone-based technology</p> <p>5. Strengthened regulatory and supervisory capacities and oversight for a sound financial sector</p> <p>6. Increased efficiency of MFIs and cost-effective retail delivery of services to the poor</p>	<ul style="list-style-type: none"> • Rules and regulations issued for e-banking transactions including e-payment transactions and e-value transfers made through nonbank institutions, including but not limited to, peer-to-peer transfers, remittances, small value transfers, and stored value transfers • Savings mobilization in MFIs increased (from 2004/2005 base) • CDA restructured into full regulatory authority • Adequate staffing and training provided for regulation and supervision of savings and credit cooperatives • Capacity building for CDA, BSP, and Securities and Exchange Commission (SEC) provided during 2005–2007 • BSP and CDA supervision and examination manuals for microfinance operations, guidelines, and training materials prepared • Off-site monitoring and on-site supervision of MFIs provided • SEC and CDA databases on MFIs and services established • Uniform set of performance standards for MFIs adopted, and increased number of MFIs using standards (from 2004/2005 base) • Standard chart of accounts adopted, and increased number of MFIs with standard chart of accounts (from 2004/2005 base) • Guidelines and model 	<ul style="list-style-type: none"> • BSP, CDA, DOF, and Congressional reports • Progress reports of ADB missions • Amendments to Republic Act No. 6939 creating Cooperative Development Authority and No. 6938 Cooperative Code submitted to Congress • BSP, CDA, and SEC monitoring and supervision reports • Documentary evidence of establishment of CDA microfinance division and hiring of staff • Manuals, guidelines, and training materials • Progress reports of ADB missions • NAPC, BSP, CDA, SEC, DOF, and MCPI reports • Consultant progress reports • Audit reports • Chart of accounts • Progress reports of ADB missions • ADB postevaluation report • Consultant and Philippine Postal 	Assumptions: <ul style="list-style-type: none"> • Effective and timely implementation of policy and legislative reforms • Sustained Government commitment to policies and reforms Risks: <ul style="list-style-type: none"> • Delays in adopting regulations or amendments • Vested interests resist opening market for remittance services Assumptions: <ul style="list-style-type: none"> • Effective and timely implementation • Sustained commitment of Government to policy and institutional reforms • Adequate capacity developed in CDA, SEC, and BSP • Agencies commitment to the regulatory and supervisory regime Risks: <ul style="list-style-type: none"> • Delay in implementing reforms • Delay in passage of legislation Assumptions: <ul style="list-style-type: none"> • Active participation of industry stakeholders • Effective implementation by MFIs • Strong demand for microfinance services • Quality consulting services • Sustained commitment of Government to privatization

Design Summary	Performance Targets	Monitoring Mechanisms	Assumptions and Risks
	business development services issued by NAPC for MFIs <ul style="list-style-type: none"> • Development of effective models of microinsurance, savings, and microinvestment 	Savings Bank (PPSB) progress reports <ul style="list-style-type: none"> • PPSB board resolutions, policy documents, and reports 	<ul style="list-style-type: none"> • Adequate investor interest
<p>7. Credit information system for efficient credit markets and access to credit at lower cost</p> <p>8. National financial literacy program and consumer protection for the poor and users of microfinance</p>	<ul style="list-style-type: none"> • Minimum qualifications and fit and proper standards issued and adopted by savings and credit cooperative board directors and key management • Sustainable systems and procedures in MFIs developed and implemented • PPSB privatization plan submitted to PPSB board of directors for approval • Valuation of PPSB completed • Draft Credit Information System Act submitted to Congress to support establishment of a credit information bureau including coverage of microfinance subsector • Increased access to credit at lower cost to the poor • Reduced credit pollution and overborrowing • National financial literacy program developed by NAPC and concerned agencies, including gender training and education on consumer protection; implementation started in 2006 • Increased number of poor participating in training program; increased financial literacy among poor and rural communities • Free public access website established by 2006 including capacity for consumer inquiries and filing complaints • Consumer protection 	<ul style="list-style-type: none"> • Progress reports of ADB missions • BSP, NCC, and Congressional reports • Progress reports of ADB missions • NAPC, BSP, CDA, and NCC data • NAPC annual report to Congress and reports of concerned agencies • National Statistics Office data • Consultants' reports • Progress reports of ADB missions • ADB postevaluation report 	<p>Risks:</p> <ul style="list-style-type: none"> • MFIs do not perceive full benefits of adopting best practice standards, practices, and reporting requirements; or delay implementation • Delay in privatization • Lack of strategic investors <p>Assumptions:</p> <ul style="list-style-type: none"> • Sustained Government commitment to creating national bureau <p>Risks:</p> <ul style="list-style-type: none"> • Delayed passage of legislation, and limited information from interim bureau <p>Assumptions:</p> <ul style="list-style-type: none"> • Effective social mobilization of the poor • Commitment of the poor to participate • Training modules designed effectively for easy learning <p>Risks:</p> <p>Lack of outreach due to geographic location and infrastructure</p>

Design Summary	Performance Targets	Monitoring Mechanisms	Assumptions and Risks
	guidebook issued including information on Philippine procedures for filing complaints		
	<ul style="list-style-type: none"> Increased consumer protection for the poor and users of microfinance services 		
Activities with Milestones <ol style="list-style-type: none"> 1.1 Amendments to Republic Act (RA) 6939 creating cooperative development authority submitted to Congress (2004/2005) 1.2 Amendments to RA 6938 Cooperative Code submitted to Congress (2004/2005) 1.3 CDA to have effective regulatory powers and authority as cooperative sector regulatory body (4th quarter 2006) 2.1 Draft credit information system act submitted to Congress (2005) 3.1 Privatization options and action plan submitted to PPSB board of directors (4th quarter 2006) 3.2 Financial assessment and valuation of PPSB completed (4th quarter 2006) 4.1 BSP draft regulation prepared to provide greater flexibility in bank branching for financially sound and well-managed banks (4th quarter 2005) 4.2 BSP regulation issued to provide greater flexibility in bank branching for financially sound and well-managed banks (4th quarter 2006) 5.1 BSP guidelines issued for pilot of risk-based supervision (4th quarter 2005) 5.2 BSP conducting risk-based supervision (4th quarter 2006) 6.1 Draft prudential rules and regulations for savings and credit cooperatives prepared by CDA and DOF, and regional consultations commenced (4th quarter 2005) 6.2 CDA to issue prudential rules and regulations for credit and savings cooperatives (4th quarter 2006) 7.1 Rules and regulations issued by BSP to facilitate low-cost transfer of remittances from OFWs to MFIs, including in remote areas (e-banking transactions including e-payment transactions and e-value transfers made through nonbank institutions including, but not limited to, peer-to-peer transfers, remittances, small value transfers, and stored value transfers) (4th quarter 2006) 8.1 Scope for national financial literacy program, including gender education and consumer protection, developed (4th quarter 2005) 8.2 Implementation started for national financial literacy program including gender education and consumer protection (3rd quarter 2006) 9.1 Information campaign launched for NAPC free public access website (2nd quarter 2006) 9.2 Completion of free public access website to support consumer protection, including capacity for filing complaints for (i) failure to meet truth-in-lending disclosure requirements, (ii) noncompliance with insurance law, and (iii) other areas as designated by NAPC; NAPC to submit complaints to relevant authorities 9.3 NAPC to publish annually information on free public access website including number of complaints received in NAPC's annual report to Congress (2006 and ongoing) 10.1 Stakeholder consultations on consumer protection guidebook for the poor and users of microfinance services (2nd–3rd quarter 2006) 10.2 Consumer protection guidebook for the poor and users of microfinance services issued, including information on Philippines' procedures for filing consumer complaints (4th quarter 2006) 			Inputs <ul style="list-style-type: none"> • ADB Program Loan: \$150 million • ADB Technical Assistance (attached): \$500,000 • ADB TA Support (TA 4544; TA 3847) • ADB mission reviews • ADB monthly monitoring and dialogue with Government • Government counterpart funding • Sector reports and data from concerned agencies • Active participation of private sector and the poor in training seminars and programs

Design Summary	Performance Targets	Monitoring Mechanisms	Assumptions and Risks
11.1 SEC administrative orders/regulation issued under the Corporation Code requiring nongovernment organizations that conduct microfinance activities to disclose this information to SEC (3rd quarter 2006)			
12.1 Guidelines and model business development services manuals issued by NAPC for widespread dissemination and distribution including free access on NAPC website (1st quarter 2007)			

STATUS OF COMPLIANCE WITH SECOND TRANCHE POLICY ACTIONS

Second Tranche Policy Conditions ¹	Status
I. Enhance the enabling policy and regulatory environment by removing regulatory impediments and policy distortions to promote market efficiencies and increased outreach of services at competitive prices to the poor	
1. Government monitoring of progress of initiatives and commitments under the Philippine Declaration on Microfinance to promote microfinance as an effective tool for reducing poverty with commitments for cooperative and collaborative action among the Government, banking community, cooperative sector, nongovernment organization sector, and development community to achieve increased outreach, impact, and sustainability	<p>Complied with.</p> <p>Cooperative and collaborative actions among Department of Finance- National Credit Council (DOF-NCC), Bangko Sentral ng Pilipinas (BSP), National Anti-Poverty Commission (NAPC), and other concerned government agencies; private sector stakeholders; and the development community have been taken to achieve increased outreach, impact, and sustainability.</p> <p>As of February 2007, the total number conduits of the People's Finance Corporation reached 202 from 199 at the end of December 2005; cumulative loan releases of ₱9 billion were made to about 2 million clients.</p> <p>The NAPC and Microfinance Program Committee reports indicate 3.1 million active microfinance clients by August 2007, with loan releases of ₱75.0 billion. The total number of MFIs, including branches, reached 2,188.</p>
2. Based upon results of exposure of the draft regulation to industry, BSP to issue regulation(s) and related guidelines providing greater flexibility in bank branching for financially sound and well-managed banks, including those catering to micro-, small-, and medium-sized enterprises	<p>Complied with.</p> <p>BSP, through Circular No. 505 (22 Dec 2005), released revised branch guidelines for banks including those catering to micro-, small- and medium-sized enterprises. The circular aims to enhance competition in the banking system and maximize the delivery of financial services especially in underserved areas. Microfinance-oriented banks and branches can now set up branches anywhere in the country provided they meet the criteria</p>

¹ Core conditions are in bold face.

	and standards. By the end of 2006, 91 new branches, including microfinance-oriented bank branches, had been approved.
<p>3. DOF and CDA to conduct public consultations; CDA to issue guidelines for truth-in-lending disclosures based upon consultations for the cooperative sector in line with BSP truth-in-lending guidelines; CDA to ensure effective compliance of cooperatives in truth-in-lending disclosure to borrowers</p> <p>NAPC to ensure that microfinance subsector stakeholders receive industry advisory on requirements under the Truth-in-Lending Law and truth-in-lending disclosures to borrowers; NAPC to post industry advisory on the NAPC free public access website, distribute it to industry associations, LGUs, and consumer and basic sector groups, and sent by direct mailings to MFIs</p>	<p>Complied with.</p> <p>Six public hearings (in February 2006) and 12 regional consultations were conducted on the Manual of Rules and Regulations. Guidelines are included in the draft manual, approved by the Philippine President and issued in October 2007.</p> <p>Industry advisory (NAPC Microfinance Industry Advisory, Disclosure of Financial Charges in the Provision of Loans/Credit) was issued on 21 November 2005 and widely distributed including posting on the NAPC website.</p>
<p>4. Securities and Exchange Commission (SEC) to issue administrative order/regulation under the Corporation Code (i) requiring nongovernment organizations (NGOs) providing microfinance and other related financial services to disclose this information to SEC by filing a revised general information sheet (GIS) within 30 days of issuance of the administrative order/regulation, and if necessary filing amended articles of incorporation; and (ii) authorizing a revised GIS form that includes a specific area for marking if the NGO conducts microfinance operations</p> <p>NAPC to maintain and develop a sector database on institutions conducting microfinance including banks, cooperatives, and NGOs; and publish data on NAPC's free public access website and in NAPC's annual reports</p> <p>SEC facilities to be established to allow for electronic filing of annual GIS forms and annual financial statements by NGO MFIs; SEC to make available to NAPC all GIS forms that</p>	<p>Complied with.</p> <p>Memorandum Circular No. 2 on Microfinance Operations of NGOs was issued on 18 January 2006.</p> <p>Memorandum Circular No. 9 (29 June 2006) was issued requiring all domestic nonstock corporations to use the revised GIS form. The form includes a specific area for marking if they are engaged in microfinance business (deposits, loans, money transfer, insurance products, payment services, and others).</p> <p>Database was developed and updated.</p> <p>Posted on the NAPC website.</p> <p>Electric filing facilities have been established.</p> <p>GIS forms are available to NAPC.</p>

<p>indicate that an NGO is conducting microfinance operations</p> <p>CDA to complete phase I of the CDA Project to establish a database for public and internal access on savings and credit cooperatives, and install advanced registration and management information systems for savings and credit cooperatives</p>	<p>Phase I of the CDA Project has been completed.</p>
<p>5. Based upon examination results and BIR evaluation report, BIR to issue revenue regulations clarifying the tax regime for MFIs and other entities engaged in microfinance transactions and activities, and specifying definitions of a party engaged in microfinance operations and a microfinance transaction; the tax treatment of microfinance transactions; and the tax status of NGOs engaged in microfinance operations</p>	<p>Complied with.</p> <p>BSP and DOF-NCC conducted a seminar on microfinance for key BIR personnel on 29 May 2006 to assist them in preparing an appropriate revenue memorandum circular. BIR issued the circular clarifying taxation of NGOs with microfinance operations in November 2007.</p>
<p>6. To facilitate financial transactions for small clients and the use of technological applications that lower the cost of transfers and payments, including remittances to MFIs in remote areas, BSP to issue rules and regulations for e-banking transactions including e-payment transactions and e-value transfers made through nonbank institutions including, but not limited to, peer-to-peer transfers, remittances, small value transfers, and stored value transfers</p>	<p>Complied with.</p> <p>The circulars issued by BSP on e-banking (Circulars 240 and 269 series of 2000) set the basic and general rules and regulations for e-banking services in the banking subsector. In addition, the Core Information Technology Supervisory Group, established in June 2005, is to issue information technology risk policies, provide baseline information technology risk standards, and align information technology policies with international best practice. For 2006, BSP issued Circular 542, which prescribes the rules and regulations to protect consumers, improve safeguards for consumer information especially from fraud and theft, promote legal enforceability of banks' electronic agreements and transactions, and prevent money laundering and terrorist financing. Circular 511 was issued to ensure that banks have the necessary skills, knowledge, and capacity to understand and effectively manage technology-related risks. As of March 2007, 87 banks (43 rural and cooperative rural banks, 11 thrift banks, and 33 commercial and universal banks) had applied and been approved for e-banking products.</p>

II. Build viable MFIs that can provide efficient and cost-effective retail delivery of services to the poor	
7. Government regulatory agencies, government financial institutions (GFIs), and other stakeholders to ensure implementation of NCC performance standards; CDA to undertake capacity building to increase oversight of compliance by savings and credit cooperatives with CDA performance standard requirements	<p>Complied with.</p> <p>Performance standards adopting NCC performance standards were established in government regulatory agencies, rural bank association, and GFIs. CDA has been conducting training sessions based on CDA performance standard requirements for regulators to strengthen oversight capacity to improve compliance of savings and credit cooperatives with standards.</p>
<p>8. DOF and CDA to conduct public consultations; CDA to issue regulations based upon consultations for minimum qualifications and fit and proper standards for savings and credit cooperative board directors and key management, including requirements for education, diligence, experience, and training</p> <p>CDA to issue ongoing training requirements for officers and directors of savings and credit cooperatives, including continuous training at an accredited organization of BSP and/or CDA</p>	<p>Complied with.</p> <p>Six public hearings (in February 2006) and 12 regional consultations were conducted on the Manual of Rules and Regulations. The manual, including requirements for minimum qualification and fit and proper standards and training, has been issued.</p>
9. DOF and CDA to conduct public consultations; CDA to issue requirements based on consultations for mandatory committees including audit; credit; election; education/training and membership; and ethics, mediation, and conciliation	<p>Complied with.</p> <p>Six public hearings (in February 2006) and 12 regional consultations were conducted on the Manual of Rules and Regulations. Requirements for mandatory committees are included in the manual issued in November 2007.</p>
10. CDA to issue a directive requiring savings and credit cooperatives to collect credit information on microfinance clients for credit information system for the microfinance subsector	<p>Complied with.</p> <p>CDA issued Resolution No. 100, 2006 approving the project proposal: Massive Inspection of Cooperatives including the requirement to collect credit information on microfinance clients. The draft Manual of Rules and Regulations requires savings and credit cooperatives to submit regular reports including credit information on microfinance clients to CDA.</p>

<p>11. NAPC in coordination with DTI and private sector business development services (BDS) providers to issue guidelines and model BDS manuals for widespread dissemination and distribution to interested parties, including free access on the NAPC website</p>	<p>Complied with.</p> <p>Activities have been undertaken under a complementary technical assistance (TA) grant from ADB (the MDP TA). The TA consultants were fielded in October 2006.</p> <p>Focus group discussions on the provision of BDS were conducted among MFI key officers and staff, and MFI clients during February–March 2007. Discussions focused on (i) strategies undertaken by MFIs in providing BDS, (ii) client demand for BDS, and (iii) good practices employed by providers. Based on the results, an industry advisory containing guidelines and best practices in BDS provision was finalized and issued by NAPC, and widely distributed including posting on the NAPC website in October 2007.</p>
<p>12. Based upon assessment and stakeholder consultations, NAPC to issue industry advisory to promote adoption of sound, sustainable microfinance schemes, including microinsurance and savings/microinvestment, in consonance with existing laws, regulations, and policies to ensure soundness of the microfinance subsector and protection of the consumer</p>	<p>Complied with.</p> <p>Activities have been undertaken under the MDP TA. The TA consultants were fielded in October 2006.</p> <p>Focus group discussions on various microfinance schemes including microsavings and microinsurance were conducted among key MFI officers and staff. The discussions focused on identifying practices adopted by MFIs and whether these practices complied with existing regulations and policies. Based on the results, NAPC finalized and issued an industry advisory promoting best practices in microfinance services in October 2007.</p>
<p>13. Financial assessment and valuation of PPSB to be completed. Privatization options and action plans for PPSB, including financial assessment and valuation of PPSB, to be submitted to, and considered by, PPSB board of directors.</p>	<p>Complied with.</p> <p>Financial assessment and valuation have been undertaken by the Privatization and Management Office financial advisor based on the latest financial statement. PPSB’s financial assessment and privatization options were discussed by the PPSB board of directors on 9 October 2007 at the board meeting.</p>

III. Strengthen regulatory and supervisory capacities and oversight authorities for a sound microfinance subsector	
14. CDA to develop and submit to authorities, for approval, reorganization plan to strengthen CDA regulatory oversight of cooperatives engaged in savings and credit services, including the identification of the appropriate CDA office(s) to monitor financial performance of savings and credit cooperatives	<p>Complied with.</p> <p>CDA submitted a proposed rationalization plan on 30 March 2006 to DOF.</p>
15. DOF to oversee CDA policies and directions, and provide appropriate guidance; CDA to ensure adoption of standard chart of accounts (SCA) by savings and credit cooperatives for effective regulatory oversight	<p>Complied with.</p> <p>Executive Order 332 mandates DOF to oversee CDA policies and direction, and provide appropriate guidance.</p> <p>CDA requests and monitors adoption of SCA by savings and credit cooperatives through the Manual of Rules and Regulations.</p>
16. DOF and CDA to conduct public consultations; CDA to issue manual of prudential rules and regulations, based on consultations for deposit-taking savings and credit cooperatives, that provide comprehensive authority for rules and regulations to implement provisions of RA 6938 and RA 6939 and other existing laws that will govern the operation of cooperatives with savings and credit operations²	<p>Complied with.</p> <p>DOF and CDA conducted regional consultation workshops during August–December 2005 and six public hearings in February 2006. The manual stipulates regulatory authorities given by the provisions of RA6938 and RA6939, and was issued and distributed to savings and credit cooperatives.</p>
17. DOF and CDA to conduct public consultations; CDA to issue reporting requirements based on consultations for savings and credit cooperatives including quarterly reporting to authorities on financial condition, and operations and internal maintenance of monthly reports	<p>Complied with.</p> <p>Six public hearings (in February 2006) and 12 regional consultations were conducted on the Manual of Rules and Regulations. Reporting requirements are included in the manual, which was issued and distributed to savings and credit cooperatives.</p>
18. BSP to conduct risk-based supervision for microfinance operations and capacity building program for BSP staff for effective risk-based supervision	<p>Complied with.</p> <p>BSP is conducting risk-based supervision for microfinance</p>

² As the comprehensive authority on rules and regulations, any changes to laws, circulars, or issuance, will subsequently be integrated and form part of the manual, while repealed rules will be deleted so that the user of the manual will no longer refer to separate issuance, but instead cite sections of the manual.

	<p>operations, and a capacity building program for BSP staff for effective risk-based supervision.</p> <p>In 2006, BSP inspected 90 banks with microfinance operations using risk-based supervisory procedures. To date, eight cycles of a 6-week structured training on risk-based supervision have been conducted with 376 participants from various offices in the supervision and examination sector.</p>
19. BSP to ensure implementation of requirements for audit, corporate governance, and risk management committees and safe and sound conduct of business	<p>Complied with.</p> <p>The BSP circulars relevant to this provision: circulars No. 434 (18 May 2004), No. 439 (5 July 2004), and No. 456 (4 October 2004) are being implemented. Banks are required to comply with these regulations and compliance is verified through examination. On 11 August 2006, the Microfinance Examination Group was created to effectively supervise and examine banks with microfinance operations.</p>
20. BSP to ensure conduct of risk management and provisioning of reserves, implementation of bank controls to determine allowance for probable losses, requirements for external independent auditors, and reporting on internal control and risk management systems for safe and sound banking	<p>Complied with</p> <p>The BSP circulars relevant to this provision: circulars No. 442 (20 July 2004), No. 463 (29 December 2004), No. 474 (3 February 2005), and No. 409 (2003) are being implemented. Banks are required to comply with these regulations and compliance is verified through examination.</p>
IV. Increase financial literacy and consumer protection for the poor	
21. NAPC to implement a sustainable national program for financial literacy, including gender training and consumer protection, in collaboration with concerned agencies, LGUs, and microfinance training institutions; NAPC to report annually on program implementation and publish results in the NAPC annual report	<p>Complied with.</p> <p>Activities have been undertaken under the MDP TA. The TA consultants were fielded in October 2006.</p> <p>The National Financial Literacy program was launched on 22 October 2007. Implementation started immediately. Program implementation will be reported in NAPC quarterly and annual reports.</p>

<p>22. NAPC to (i) issue, in consultation with concerned agencies, a guidebook on consumer protection for the poor and users of microfinance services, including information on Government procedures for filing consumer complaints; and (ii) publish the guidebook on the NAPC free public access website and distribute it to industry associations, LGUs, MFIs, and consumer and basic sectors groups</p>	<p>Complied with.</p> <p>With the assistance of the MDP TA, a consumer protection guidebook and a guidebook on the NAPC website were published and widely distributed to stakeholders in October 2007.</p>
<p>23. NAPC to develop a free public access website and operate it to support consumer protection, including capacity for the public to file complaints online for (i) failure to meet truth-in-lending disclosure requirements; (ii) noncompliance with insurance law; and (iii) other areas as identified by NAPC; NAPC to submit complaints to relevant authorities, and publish the number of complaints received annually in the NAPC annual report</p> <p>NAPC to ensure that microfinance subsector stakeholders receive an industry advisory on requirements under the Insurance Law and requirements for offering insurance products. Advisory to be posted on NAPC's free public access website; distributed to industry associations, LGUs, and consumer and basic sector groups; and sent by direct mailings to MFIs</p>	<p>Complied with.</p> <p>Development of NAPC's website was undertaken under the MDP TA. In October 2007, the website included capacity for the public to file complaints online. NAPC will submit complaints to relevant authorities, and number of complaints received will be published annually in NAPC's annual report.</p> <p>NAPC issued an industry advisory on requirements under the Insurance Law (Microfinance Industry Advisory on Provision of Insurance, 21 November 2005). The advisory was posted on NAPC's website for public access and its hard copy was widely distributed. A new advisory on more specific requirements was prepared and issued on 11 October 2007.</p>
<p>24. DOF and CDA to conduct public consultations; CDA to issue regulation requiring savings and credit cooperatives to designate an officer as the compliance officer responsible for cooperatives' compliance with applicable laws and regulations; CDA to establish a training program for compliance officers with a specified transition period for officers to complete the training included in the regulation to ensure effective compliance</p>	<p>Complied with.</p> <p>Six public hearings (in February 2006) and 12 regional consultations were conducted on the Manual of Rules and Regulations The manual includes provisions for the requirements of compliance officers and transition period for officers to complete training. It was issued and distributed by CDA to stakeholders.</p>

RECENT POLICY DEVELOPMENTS

A. Background

1. On 9 August 1999, then President Joseph Ejercito Estrada issued Executive Order (EO) 138, which among other things rationalized implementation of government-directed credit programs. It specifically mandated, among other things, the following:

- (i) adoption of market-based interest rates for all government credit programs,
- (ii) provision of the appropriate and enabling policy environment by government to encourage greater private sector participation in the delivery of credit services to the basic sector,
- (iii) nonparticipation of government nonfinancial agencies (GNFAs) in the implementation of government credit programs,
- (iv) transfer of the implementation of ongoing government credit programs from GNFAs to government financial institutions (GFIs), and
- (v) limitation of the role of GFIs to the wholesale provision of loanable funds to retail private financial institutions.

2. The provisions of EO 138 complement and support the provisions of the Republic Act (RA) 8435: Agriculture and Fisheries Modernization Act and RA 8425: Social Reform and Poverty Alleviation Act.¹ The two acts mandate the adoption of market-based credit and financial policies in the agriculture sector and in the provision of financial services to the poor. The Agriculture and Fisheries Modernization Act in particular calls for the phase out of directed credit programs in the agriculture sector and the consolidation of these programs in the Agriculture Modernization Credit and Financing Program. Under the program, market-based interest rates will be adopted and funds will be channeled through GFIs mandated to provide wholesale loan funds to private financial institutions. The Social Reform and Poverty Alleviation Act mandates the adoption of market-based interest rates for microfinance and provision of capability building assistance to institutions willing to provide financial services to the poor.

3. On 8 August 2006, the Government issued EO 558 repealing the provisions of EO 138. The new EO was clarified by EO 558-A, issued on 27 October 2006. EO 558-A aims to meet the credit needs in the 47 unserved areas through new credit programs. Specifically, EO 558-A defines the scope and coverage of government involvement in microfinance lending as follows:

- (i) Credit programs to be implemented under EO 558-A will be limited to 47 municipalities currently not served by private financial institutions as identified by the People's Credit and Finance Corporation (PCFC).
- (ii) The Department of Social Welfare and Development (DSWD) is mandated to implement credit programs in the identified unserved areas using simplified documentation procedures.

¹ Both acts became effective in 1998.

- (iii) The interest rate of Quedan and Rural Credit Guarantee Corporation² will be used as the basis for determining interest charges on loans to be granted to borrowers in the unserved areas.
- (iv) PCFC will provide the necessary support services to existing private financial institutions that are willing to provide microfinance services in the unserved areas.
- (v) PCFC will oversee and monitor implementation of credit programs in the identified unserved areas.
- (vi) All other credit programs to be implemented by GOCCs and GNFA's will require approval from the President.

B. Microfinance Programs under EO 558-A

4. Under EO 558-A, the KAPAKANAN (Kakayahan or Capacity, Pagtitiwala or Trust, Aksyon or Action at Puhunan or Capital) Program was launched as a new window to provide microfinance to targeted groups of marginalized residents of marginalized regions, in addition to the existing microenterprise program of the National Livelihood Support Fund (NLSF). The KAPAKANAN Program is funded by NLSF and operated by DSWD. NLSF will provide up to ₱100 million for program implementation. The first tranche of ₱25 million has been released with the remaining three tranches of ₱25 million each to be released on full utilization of prior releases and submission of required reports. The program will cater to self-help groups engaged in nonfarm enterprises with capacity building assistance and provision of working capital. The minimum loan amount is ₱5, 000 and maximum ₱50, 000 with repayment period of up to 2 years. Loans under the Program are provided to microenterprises only in the 47 unserved municipalities where no private MFIs operate, as defined by PCFC. A gap between the NLSF lending rate of 9% per annum and lending rate to borrowers capped by Quedan and Rural Credit Guarantee Corporation's lending rates (currently 16% per annum for production purposes and 24% per annum for nonproduction purposes) serves as management fees to DSWD.

5. DSWD is collaborating with local government unit social workers in implementing KAPAKANAN Program screening, identifying borrowers through means tests, and providing training and capacity building assistance including skills training and development of entrepreneurial skills to borrowers. DSWD assesses client demand for credit not attended by private sector MFIs. DSWD has started implementing the Program in Luzon, and will follow with implementation in the Visayas. The Development Bank of the Philippines will undertake program implementation in Mindanao. Both DSWD and Development Bank of the Philippines report on program activities on a quarterly basis to PCFC, which reports the program implementation status to NAPC. Program implementation will be discontinued once a targeted municipality starts to receive microfinance service from private sector MFIs in accordance with the program implementation guidelines.

² This is a government-owned corporation established by Republic Act No. 7393 in 1992 to provide credit support to farmers, fisherfolk, rural workers, cooperatives, retailers, wholesalers, and primary processors of agricultural and aquatic commodities.

C. Assessment

6. Unserved areas targeted by EO 558-A are generally those characterized by inadequate infrastructure, market services, and entrepreneurial skills. Not surprisingly, private sector MFIs have difficulty penetrating these areas. These constraints to penetration by private MFIs have also impeded implementation of EO 588-A. To date, only ₱1.3 million (approximately \$29,000) has been disbursed to self-help groups in one province³ as of June 2007. The limited and targeted scope of the new EO, and the limited funding allocated to it suggest that it is unlikely to have a major impact on the sector.

7. Furthermore, little substantive evidence is available of a major policy reversal in the sector, other than the repeal of EO 138. EO 138 was perceived as a major element in promoting the expansion of microfinance in the Philippines on a sustainable basis. A key feature is that the lessons are being extended to rural and SME finance. This is supported by a widening array of legislative acts that have extended the applicable scope of market-based principles for finance. These positive developments have served to deepen the foundations created under EO 138 for sustainable, market-driven microfinance. Thus, the philosophy underlying EO 138 was incorporated in several sector laws implemented after EO 138 was issued. The Agricultural and Fisheries Modernization Act phases out directed credit programs for the agriculture sector and mandates market-based credit policies, with GFIs acting primarily as wholesalers of funds for agriculture. Likewise, the Social Reform and Poverty Alleviation Act adopts market-based interest rates for microfinance, with government funds to be used primarily for capacity building.

8. Furthermore, and perhaps most importantly, the General Banking Act of 2000 (RA 9478) recognizes the “characteristics of micro financing, such as cash flow-based lending to the basic sectors that are not covered by traditional collateral” in section 40. This provision mirrors EO 138 in calling for a greater private sector role in the provision of financial services to the sector and adoption of market-oriented financial and credit policies. As a consequence of this act, BSP has issued a number of circulars that resulted in an increased number of rural and thrift banks providing microfinance services under the provisions of the act. Indeed, with the passage of the General Banking Act, subsequent legislation has been drafted in conformity with its provisions. Thus, section 9 of Barangay Micro Business Enterprise Act of 2002 (RA 9178) also mirrors EO 138 in encouraging private sector participation in the delivery of financial services to microenterprises through the provision of wholesale funds to private financial institutions and requiring GFIs to set up special microfinance wholesale credit windows consistent with the policies, rules, and regulations of BSP.⁴

9. The repeal of EO 138 has engendered a vigorous debate on the subject. For example, at the Philippine Congress a draft house bill was submitted to formally embed, in a single piece

³ Masbate.

⁴ This section states that “...Upon the approval of this Act, the Land Bank of the Philippines (LBP), the Development Bank of the Philippines (DBP), the Small Business Guarantee and Finance Corporation (SBGFC), and the People's Credit and Finance Corporation (PCFC) shall set up a special credit window that will service the financing needs of BMBEs registered under this Act consistent with the Banko Sentral ng Pilipinas (BSP) policies, rules and regulations. The Government Service Insurance System (GSIS) and Social Security System (SSS) shall likewise set up a special credit window that will serve the financing needs of their respective members who wish to establish a BMBE. The concerned financial institutions (FIs) encouraged to wholesale the funds to accredited private financial institutions including community-based organizations such as credit, cooperatives, non-government organizations (NGOs) and people's organizations, which will in turn, directly provide credit support to BMBEs.”

of legislation, all the principles originally contained in EO 138.⁵ However, despite the repeal of EO 138, the market principles stipulated in the existing legislative framework have broadened and deepened. These principles, embedded in law, provide assurance of the durability of the current microfinance policy. The commitment to market-based financing for microfinance appears strong within government agencies. This is not surprising as the GFIs, BSP, and DOF/NCC have long been implementers of key elements of the EO 138 philosophy. Finally, the Government has gone on to facilitate the operation of private sector MFIs with its “Text an MFI Program” through which private MFIs can be more readily located.

⁵ House Bill No. 5788 entitled, “An Act Providing a Sustainable Loan Program through a Rationalized Government-Private Sector Financial Services System, and for Other Purposes” submitted by Representative Teofisto Guingona III in October 2006. After dissolution of Congress, a new House Bill of the same objective is being prepared for submission to 2007 Congress in November 2007. A similar Bill is likewise being drafted by Senator Benigno Aquino Jr., which will be simultaneously filed at the Senate.