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Financial Inclusion, Education, and Regulation in the Philippines

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Abstract

Establishing financially inclusive ecosystems for low-income clients, including small and medium enterprises, has become a rising global concern. The Consultative Group to Assist the Poor and the World Bank estimate that around 2.7 billion adults worldwide do not have access to credit, insurance, or savings with a bank or other formal institution. Several studies have argued that financial inclusion empowers the poor to manage their finances and reduce their vulnerability to financial distress, debt, and poverty. The key issues are why formal financial systems are not inclusive, and how they can be made inclusive of the poor. In the Philippines, the government has identified financial inclusion as an important strategy for inclusive growth. This paper discusses the current status of financial inclusion, education, and regulation in the Philippines and measures to foster financial inclusion. The primary policy challenge faced by the government is defining its role in creating the broad and interconnected ecosystems needed for safe and efficient product delivery to the poor.

JEL Classification: G18

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1. INTRODUCTION

Establishing "financially inclusive ecosystems" (Ehrbeck, Pickens, and Tarazi 2012) wherein financial markets provide more people, especially low-income clients, with a broad array of financial products and services at lower costs has become a rising global concern. The Consultative Group to Assist the Poor (CGAP) and the World Bank estimate that around 2.7 billion adults worldwide do not have access to credit, insurance, or savings with a bank or other formal institution (Ehrbeck, Pickens, and Tarazi 2012). CGAP (2011a) has stressed the importance of access to formal financial services for the billions of people around the world who currently lack adequate access. Several studies have argued that financial inclusion empowers the poor to manage their finances and reduce their vulnerability to financial distress, debt, and poverty. In the Philippines, the government has identified financial inclusion as an important strategy, among others, for inclusive growth (Philippine Development Plan 2011–2016).

The key issues are why formal financial systems are not inclusive, and how can they be made inclusive of the poor. To address these issues, policy makers and financial institutions try to foster comprehensive approaches that can overcome supply- and demand-side barriers to financial inclusion. Two broad types of barriers are reported in the literature: supply-side and demand-side barriers. Supply-side barriers consist of high transaction costs, information asymmetry, and poor regulatory frameworks that hinder the quantity and quality of financial products and services that are accessible by the poor. Demand-side barriers constitute a range of factors that have effectively excluded individuals, especially the poor, from accessing financial services—socio-economic and cultural elements, challenges posed by the lack of formal identification systems, and low levels of financial literacy in addition to the absence of appropriate consumer protection mechanisms (Alliance for Financial Inclusion 2010). Other factors that drive exclusion of the poor from financial services are a lack of awareness of available services, inappropriateness of certain services to the needs of the low-income sectors, and the risks of dealing with poor customers (ESCAP 2014).

This paper discusses the current status of financial inclusion, education, and regulation in the Philippines and some measures to foster financial inclusion. Financial inclusion is a major policy issue, which implies the importance of financial literacy to educate the poor on how to manage their finances, and financial regulation to ensure financial stability amidst the growing number of financial innovations designed to reach the poor.

Bangko Sentral ng Pilipinas (2013: 1) defines financial inclusion as "a state wherein there is effective access to a wide range of financial services for all Filipinos." This paper follows this definition. "Effective access" means that financial services are appropriately designed, of good quality, relevant for actual use, and beneficial to the target market. Financial services cover a wide range of products and services such as savings, credit, payments or remittance, and insurance for different market segments, especially the unbanked. This definition conforms with CGAP's and GPFI's (2011a: 1) definition of financial inclusion as a "state in which all working age adults have effective access to credit, savings payments, and insurance from formal service providers."

The paper is organized as follows: after a brief introduction, Section 2 presents an overview of financial inclusion in the country and focuses on microfinance, highlighting the factors that drive financial inclusion and those that hinder its progress. Microfinance is used in a large sense to cover savings, credit, and insurance products designed for low-income clients. Section 3 examines financial education in low-income sectors and the emerging issues. Section 4 identifies regulatory gaps and highlights issues regarding the need for balance between financial inclusion and financial stability. Section 5 concludes with some policy recommendations.

2. FINANCIAL INCLUSION

2.1 Brief Profile of the Philippine Financial System

In 2014, the Philippine banking system remained strong and stable despite external challenges, especially in international capital markets, with continuing growth in resources, deposit liabilities, and loans. The total resources of the whole banking system increased by 11.8% to more than P11 trillion ($260.6 billion), from P10.3 trillion ($233.2 billion) in the preceding year, 2013. This can be attributed to growth in loans, financial assets, and equity investments. Total deposits of banks rose to P8.52 trillion ($192.7 billion) in the same period, a 12% year-on-year increase from end-December 2013. The number of banking institution head offices decreased to 648 as of end-December 2014 from the previous year's 673 head offices, signifying a consolidation of banks and the closure of weaker banks in the sector. Asset quality indicators also improved with the decline of the banking system's gross non-performing loan (GNPL) ratio from 2.8% as of end-December 2013 to 2.3% as of end-December 2014. Likewise, net non-performing loans were reduced. Capital adequacy ratios (CARs) remained above the international standards imposed under the Basel III framework, which became effective on 1 January 2014. As of end-September 2014, CARs of universal and commercial banks stood at 16.3%, while overall the CAR ratio for all types of banks stood at 17.0% at end-September 2014 (Table 1).

Table 1: Resources, Deposits, and Loans Outstanding, All Banks, December 2014

	All	Universal Commercial Banks	Thrift Banks	Rural Banks
Number of Banks				
Total number of Banks	10,361	6,330	1,920	2,608
Head offices	648	51	69	543
Other Offices	9,713	6,279	1,851	2,065
Resources (P billion)	11,128.3	10,398.4	916.2	208.9
Deposits Liabilities (P billion)	8,522.3	7,680.6	697.6	144.1
Loans Outstanding (P billion)	5.531.6	4,822.3	570.9	138.4
GNPL to Total Loans (%)	2.3	2.3	4.4	11.9
NNPL to Total Loans (%)	0.6	0.6	1.95	5.9
Capital Adequacy Ratio (%)	16.7*	17.0**		

GNPL = gross non-performing loans; NNPL = net non-performing loans.

* As of end-June 2014

** As of end-September 2014

Source: Bangko Sentral ng Pilipinas.

2.2 State of Financial Inclusion

To contextualize the discussion of financial inclusion, a comparison of the Philippines with other ASEAN countries is given using data from the 2011 Global Findex Report

(Tables 2, 3, and 4). The Global Findex website provides information on savings and loan accounts at formal financial institutions by sex, income, age group, education, and place of residence (urban or rural). The tables indicate relatively low access to and usage of financial services in the country compared to Singapore, Malaysia, and Thailand, the three high–middle income countries in the ASEAN region. Singapore has the most financially inclusive system, while the Philippines, together with the Lao People's Democratic Republic, Cambodia, Indonesia, and Viet Nam, have access to financial services that are lower than those of East Asia and the Pacific and the world. Tables 2, 3, and 4 signify the great challenge faced by the Philippines in working for greater inclusiveness of its financial ecosystem.

Table 2: Account at a Formal Financial Institution, by Classification, 2011

(% aged 15+)

	Sex		Income		Age Group		Education		Classification	
	Male	Female	Bottom 40%	Top 60%	Older adults	Young adults	Primary education or less	Secondary education or more	Rural	Urban
Cambodia	3.6	3.7	1.7	5.4	3.3	4.5	2.2	15.5	2.4	10.2
Indonesia	20.0	19.2	10.3	26.4	21.6	12.8	10.2	29.4	16.2	28.9
Lao PDR	27.4	26.2	20.1	31.7	28.5	23.0	22.0	34.7	20.2	32.0
Malaysia	69.2	63.1	50.1	76.9	70.5	57.1	39.7	74.1	51.8	77.6
Philippines	19.0	33.7	10.4	39.6	29.7	18.3	12.3	33.1	19.5	37.1
Singapore	98.2	98.2	97.4	98.8	99.0	94.7	94.4	99.9	...	98.2
Thailand	72.7	72.6	61.3	79.3	75.4	59.3	63.8	91.1	70.0	81.7
Viet Nam	24.0	18.9	10.6	30.1	21.1	22.6	4.5	32.3	16.5	29.8
East Asia and the Pacific	57.8	52.1	39.3	65.9	55.9	49.9	49.7	65.0	50.1	68.7
World	54.5	46.6	40.7	58.5	54.8	36.8	36.9	66.0	44.1	59.6

... = not available; Lao PDR = Lao People's Democratic Republic.

Source: Global Findex (2011).

Table 3: Savings at a Formal Financial Institution, by Classification

(% aged 15+)

	Sex		Income		Age Group		Education		Classification	
	Male	Female	Bottom 40%	Top 60%	Older adults	Young adults	Primary education or less	Secondary education or more	Rural	Urban
Cambodia	1.5	0.2	0.2	1.4	0.8	0.9	0.6	2.8	0.7	1.1
Indonesia	14.7	15.9	7.8	20.8	17.0	9.5	7.3	23.6	12.5	22.9
Lao PDR	19.8	19.0	12.9	24.1	19.6	18.7	16.2	24.6	15.7	22.3
Malaysia	40.6	30.2	22.3	44.1	39.1	26.6	19.8	39.6	29.7	40.0
Philippines	11.2	18.0	3.0	24.1	15.6	12.4	4.5	19.4	9.7	22.3
Singapore	58.1	58.7	51.9	63.1	60.2	49.9	41.6	65.8	...	58.4
Thailand	42.8	42.8	36.4	46.5	46.4	25.4	37.1	54.7	43.2	41.5
Viet Nam	8.9	6.7	3.8	10.9	9.6	2.7	1.4	12.0	5.7	11.2
East Asia and the Pacific	28.4	28.5	16.1	37.1	30.5	19.7	23.9	37.4	24.3	40.2
World	23.9	21.0	15.3	28.3	24.8	15.0	14.5	31.6	18.9	27.3

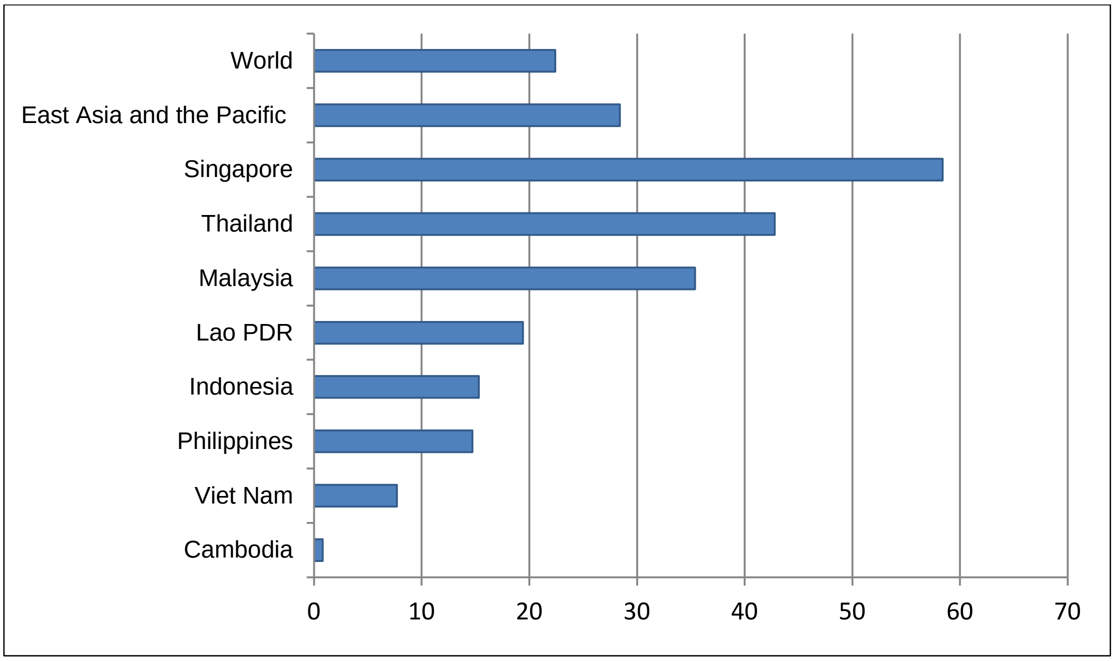
... = not available; Lao PDR = Lao People's Democratic Republic.

Source: Global Findex (2011).

The 2009 Consumer Finance Survey of the BSP reported that 8 in 10 Filipino households did not have a deposit account; 93% of those with no deposit accounts said they did not have enough money for bank deposits (BSP 2012). Table 3 and Figure 1 show comparative data on the percentage of savers 15 years and older in the ASEAN region from Global Findex. The Philippines and Indonesia have fewer savers 15 years and older than the Lao People's Democratic Republic (Lao PDR). While the Global Findex data provide a snapshot of the savings picture in 2011, data from the IMF Financial Access Survey in the period 2004–2013 show a rising proportion of deposit accounts per 1,000 adults since 2009 (Figure 2). The different data sources show the status of savings from different perspectives. The data reported by the IMF refer to the number of deposit accounts per 1,000 adults while Global Findex reports the percentage of savers 15 years and older. The BSP Consumer Finance Survey reports the number of households without deposit accounts. Nevertheless, the overall picture one gets is that a large segment of the population has relatively low access to deposit services.

Figure 1: Savings at a Formal Financial Institution

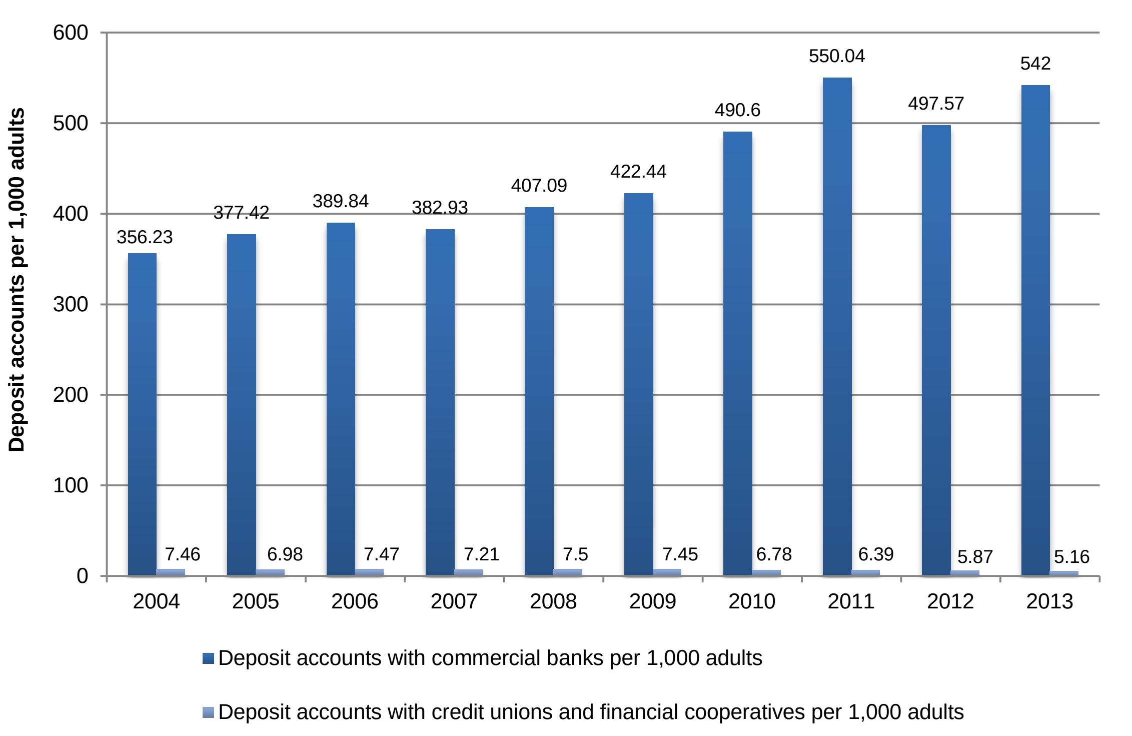
(% aged 15+)



Lao PDR = Lao People's Democratic Republic.

Source: Global Findex (2011).

Figure 2: Deposit Accounts per 1,000 Adults in the Philippines, 2004–2013



Source: IMF Financial Access Survey.

Overall, there is low access to loans from formal institutions (Table 4). This is substantiated by data from the World Bank that only 10.5% of adults in the Philippines had a loan from a formal financial institution in 2010 (BSP 2012).

Table 4: Loans from Formal Financial Institutions by Classification
(% aged 15+)

	Sex		Income		Age Group		Education		Classification	
	Male	Female	Bottom 40%	Top 60%	Older adults	Young adults	Primary education or less	Secondary education or more	Rural	Urban
Cambodia	18.7	20.1	18.4	20.4	23.6	9.5	21.2	5.7	20.6	13.4
Indonesia	9.0	8.2	6.4	10.1	10.2	3.7	7.3	10.0	8.7	8.0
Lao PDR	19.1	17.2	17.6	18.5	20.0	13.9	18.0	18.4	19.5	17.0
Malaysia	12.1	10.3	1.8	17.4	12.8	7.6	4.2	13.1	5.5	15.7
Philippines	8.1	12.8	5.1	14.9	13.3	3.0	9.0	11.2	9.8	11.6
Singapore	13.8	6.3	6.1	12.8	10.5	7.4	3.2	13.0	...	10.0
Thailand	21.1	17.9	26.9	15.0	22.1	6.3	22.3	13.4	22.6	8.4
Viet Nam	17.2	15.2	15.4	16.8	18.4	9.8	18.7	15.2	20.7	8.3
East Asia and the Pacific	9.4	7.8	8.5	8.7	9.5	4.3	8.2	9.4	8.5	8.8
World	10.0	8.1	8.3	9.7	10.4	4.4	7.3	11.1	8.9	9.2

... = not available, Lao PDR = Lao People's Democratic Republic.

Source: Global Findex (2011).

Micro-entrepreneurs and small enterprises also suffer from limited access to a range of financial services despite the mandatory credit allocation imposed by law. The Magna Carta for Micro, Small, and Medium Enterprises, a law passed by the Philippine Congress mandated that from June 2008 to June 2018, banks must allocate at least

8% of their loan portfolio for micro and small enterprises, and at least 2% for medium enterprises. Table 5 shows the compliance rate of Philippine banks to the Magna Carta.

Table 5: Compliance with Mandatory Credit of 8% to Micro and Small Enterprises

(%)

Bank Type	2008	2009	2010	2011	2012	2013	2014
All	10.00	9.70	8.46	7.56	6.39	5.59	4.90
Universal and commercial banks	7.10	7.12	6.76	5.78	5.29	4.58	3.95
Thrift banks	16.35	16.12	14.02	16.23	11.26	9.80	7.36
Rural banks	51.82	41.14	34.07	29.58	22.27	26.04	24.81

Source: Bangko Sentral ng Pilipinas.

Only the rural banks consistently complied with the required 8% from 2008 to 2014. Compliance for universal and commercial banks was below the required rate and declined over the period. Meanwhile, thrift banks' compliance also declined and in 2014, they did not meet the mandatory allocation. The total loan portfolio of all banks increased by a compound average growth rate of 16.07% from 2008 to 2012, but lending to micro and small enterprises grew only by a compound average growth rate of 3.05%.

In sum, in terms of usage of financial services, a relatively small segment of the population has deposit and loan accounts. The rise in the number of savings and loan accounts gives an idea of the growth of financial inclusion, but this cannot simply be interpreted as an improvement in accessibility of loans and deposit services. An individual may have more than one deposit or loan accounts depending on his/her needs, type of business activity or profession, or for other reasons. It is important to implement the planned baseline survey mentioned by the BSP to find out exactly how many individuals have deposit and loan accounts.[1] The next best sources of information on financial inclusion are the reports by microfinance institutions and micro-insurance providers. Unfortunately, the reported loans and deposits are also in terms of the number of accounts. Nonetheless, these institutions cater to the low-income sectors and the data that they report somehow reflect the progress made in expanding financial inclusion.[2]

2.3 Microfinance

In the Philippines, financial inclusion of the excluded segment of the population comes mainly from the efforts of microfinance institutions (MFIs), especially rural banks with microfinance operations.[3] Microfinance loans rose constantly during the 2002–2013 period from P2.6 billion ($85.79 million) to P8.7 billion ($196.73 million), equivalent to an 11.6% compound annual growth rate. The number of deposit accounts increased

[1] From an interview with Ms. Pia Roman, Inclusive Finance Advocacy staff, Bangko Sentral ng Pilipinas.

[2] The following discussion reports data on financial inclusion from the BSP.

[3] Other MFIs are credit cooperatives and other types of institutions. Unfortunately, there are no reliable data and information on the performance of credit cooperatives, and hence their contribution to financial inclusion is not mentioned in this paper. The supervision and regulation of credit cooperatives is weak and patchy. An example of weak performance is the failure to maintain an updated registry of functioning cooperatives and data on their financial status and performance. The Cooperative Development Authority is the governmental regulatory institution for cooperatives.

from 34.52 million in 2009 to 43.35 million accounts in 2013, equivalent to an average annual growth of 7.1%, except in 2012 when it suffered a 4.3% year-on-year decline, owing mainly to a decrease in the number of deposit accounts in the National Capital Region. In 2013, small savers, including those using non-stock savings and loan associations (NSSLAs) managed to increase their savings deposits. The use of basic financial services (loans and deposits) has expanded.

However, there is disparity in the distribution of financial services access points because banks are found mostly in high income and urban areas. Bangko Sentral ng Pilipinas notes that 43% of the total number of deposit accounts and 67% of the total amount of deposits are in the National Capital Region (NCR). Many areas in the country are still underserved or even unserved, indicating the great challenge to financial inclusion. The country is an archipelago of more than 7,000 islands and geography poses formidable barriers to accessibility of financial services delivered through traditional “brick and mortar” branch banking.

Fortunately, modern technologies, e.g., e-money and mobile banking, can help overcome the physical barriers to financial inclusion poised by the country’s archipelagic topography. E-money accounts and e-money transactions have significantly grown in the past few years. There are now 26.7 million e-money accounts and 10,620 active e-money agents performing cash-in/cash-out transactions throughout the country (Table 6).

Table 6: Electronic Money Indicators

	2010	2013	Growth Rate
E-money Accounts (in millions)	19.9	26.7	34.0%
Number of E-money Transactions (in millions)	138	217	57.0%
Value of E-money Transactions (P billion)	220.5	348	58.0%

Source: Bangko Sentral ng Pilipinas.

Registered e-money accounts increased by 34% to 26.7 million accounts in 2013 from 19.9 million accounts in 2010 (BSP 2015). E-money accounts in 2013 were composed of 8 million mobile wallets and 18.7 million cash cards. The number of e-money transactions has also significantly grown over the years. From 138 million transactions in 2010, the number of e-money transactions jumped by 57% to 217 million transactions in 2013. In terms of amount, the total value of e-money transactions rose by 58% to P348 billion ($7.9 billion) in 2013 from P220.5 billion ($4.99 billion) in 2010 (BSP 2014). Available data also show that a large number of the population has used domestic payment services. A 2010 study of Bankable Frontier Associates reported by BSP revealed that 55% of Filipino adults have availed themselves of money transfer, loan, and bill payment services. The total size of the domestic payments market is estimated at $3.2 billion per month used by an estimated 41 million people (BSP 2012). This includes the remittances made by overseas Filipino workers to their families.

There is indeed great potential in using mobile banking to expand financial inclusion as three out of four Filipinos are unbanked, 50% of active mobile money users are unbanked, and the low income group uses mobile money to send and receive remittances (Demiguc-Kunt, Beck, and Honohan 2008). Mobile banking shows the advantage of using technology that is not constrained by poor physical infrastructure (roads and seaports) and high transaction costs in hard-to-penetrate areas. The government, especially the regulators, should pay more attention to issues of connectivity, reliability, and affordability of telecommunication services, especially in areas outside the major urban centers.

2.4 Microinsurance

Another important area of financial inclusion is microinsurance given to low-income clients. Microinsurance is defined following Churchill (2006) as insurance that (i) operates by risk-pooling; ii) is financed through regular premiums; and is (iii) tailored to the poor who would otherwise not be able to take out insurance. Microinsurance is generally for those who are excluded from traditional commercial insurance schemes because they come from the informal sector, have irregular cash flows, or have seasonal fluctuations in earning capacity (Churchill 2006; Llanto 2007). The Regulatory Framework for Micro-insurance developed by the government defines microinsurance as the “activity of providing specific insurance, insurance-like and other similar products and services that meet the needs of the low-income sector for risk protection and relief against distress, misfortune or other contingent events” (Department of Finance 2012).[4] A recent development in the Philippines is the provision of microinsurance and similar products by regular insurance companies and mutual benefit associations to help low-income clients deal with vulnerability risks and catastrophic events.[5] This, together with the growth of microfinance, has enabled a large segment of the excluded population to access basic financial services.

Providing poor households or low-income clients with microinsurance is an important component of financial inclusion strategies. Although research on microinsurance is still at an “embryonic stage” with many questions to be asked and options to be tried before solutions on how to protect significant numbers of the world’s poor against risk begin to emerge (Salazar-Xirinachs 2008), the case for microinsurance is well-stated in the literature. Dercon and Kirchberger (2008) in reviewing the literature pointed to a body of research work (Morduch 1990; Dercon 1996, 2004; Rosenzweig and Binswanger 1993; Elbers et al. 2007; Pan 2008) examining the reasons for taking microinsurance cover and the welfare gains arising from this type of social protection scheme. Poor households could become vulnerable to catastrophic shocks when risks are left uninsured. Faced with such uninsured risks, poor households may undertake costly strategies to manage their incomes and assets, e.g., selling earning assets, incurring costly debt, or dissaving. There could be significant welfare losses and forgone earning opportunities, which could drive households to penury.

Table 7 lists a few instruments used by low-income households in the Philippines to cope with the negative outcomes of risk events. In the case of low-income clients, formal microinsurance can provide greater and more certain benefits than the informal “protection” schemes devised in the informal economy, which provide inadequate cover from external shocks. Box 1 summarizes information on microinsurance and other activities showing the current situation and the progress made so far in extending risk protection, especially to low-income clients.

[4] The amount of premiums, fees, or charges computed on a daily basis does not exceed 5% of the current daily minimum wage rate for non-agricultural workers in Metro Manila, and (b) the maximum sum of guaranteed benefits is not more than 500 times the daily minimum wage rate for non-agricultural workers in Metro Manila.

[5] CGAP (2012) explains: “Emergencies, such as a sickness in the family, and large outlays, such as school fees, may come during lean times. Even in the best of times, poor people have less of a cushion to weather shocks.” Data on microinsurance are also limited because of inefficient data collection by concerned government agencies.

Table 7: Coping Instruments of Low-income Philippine Households

Coping Mechanism	Description
Informal, on-the-spot action	Support from relatives, loans from money lenders, sale of assets, e.g., livestock, farm animals
Local informal “social protection” schemes	Support from rotating savings and credit associations, and other informal schemes
Institutional insurance schemes	Social security system, government service insurance system, commercial insurers, if the households are able to access them.
Microinsurance schemes	Schemes developed by MFIs, mutual benefit associations, cooperatives

MFI = microfinance institution.

Source: Adapted from Llanto (2007).

Box 1: Microinsurance, Progress So Far

BSP (2014) Report

- In 2013, there were 81 banks with no objection notice from the BSP to offer microinsurance, while 40 banks had already obtained the authority to market, sale, and service microinsurance products.[a]
- Data from the Rural Bankers Association of the Philippines showed that the total number of insured clients by rural banks with microinsurance rose by 153% to 1.4 million in 2013 from around 543,500 in 2012.[b]
- According to the Insurance Commission, microinsurance coverage among Filipinos rose to 19.95 million (20.4% of the population) in 2013 from 3.1 million (3.4% of the population) in 2008. This makes the Philippines one of the top microinsurance markets in Asia. The strong collaboration between insurance providers and the regulator were significant factors contributing to the rapid growth of microinsurance in the country.

Department of Finance-National Credit Council (2012)

Before 2008	July 2012
► Microinsurance products mostly credit life except for MBA microinsurance products	► 80 microinsurance products approved (54 life and 26 non-life)
► Six licensed MBAs selling microinsurance products	► 27 licensed MBAs selling microinsurance
► Few commercial insurance companies with microinsurance products	► 28 insurance companies (16 life and 12 non-life) selling microinsurance products
► No microinsurance agent category	► 116 licensed as microinsurance agents (26 rural banks and 90 individuals)
► 3.1 million individuals covered by microinsurance MBAs	► About 7.8 million insured, including dependents, covered under microinsurance

BSP = Bangko Sentral ng Pilipinas, MBA = mutual benefit association.

[a] Banks wanting to become insurance agents need to obtain a “no objection notice” from the BSP and approved authority to cross-sell microinsurance from the Insurance Commission.

[b] Based on the data submitted by four commercial insurance companies and two MBAs that have existing partnerships with rural banks.

Source: Department of Finance, Government of the Philippines (2012).

2.5 Factors Driving the Development of the Microfinance Sector

An interplay of external and internal factors drives the development of the microfinance sector.[6] External factors are "push" factors coming from outside that motivate microfinance institutions (MFIs) and microinsurers to develop innovative financial products and services to expand outreach to more low-income clients. Internal factors are "pull" factors coming from within those institutions prodding them to develop internal capacities for delivering better service to clients.

The primary push factor is the government's policy decision to make the financial system more inclusive. The current Philippine Development Plan 2011–2016 has a three-pronged financial inclusion strategy: (a) increasing the confidence of the public about the health of the financial sector; (b) educating the public on financial instruments and their rights; and (c) encouraging the offering of a variety of products to cater to different consumers. The BSP as the lead government institution has formulated specific financial inclusion strategies (Table 8).

Table 8: Financial Inclusion Strategies

Specific Strategy	Instruments	Specific Target
Policy, regulation, and supervision	BSP Circulars 730, 754, and 755 to enhance the implementation of the Truth in Lending Act (RA 3765)	Ensure adequate disclosure of the true cost of credit, which protects consumers and enables them to make informed decisions about borrowing
	BSP Circular 746, which grants exemptions from the submission of documents like income tax returns and financial statements to clients.	Streamline access to finance by MSMEs
	BSP Circular 694	Facilitate the establishment of micro-banking offices to expand the physical network of banking offices in areas without banks or alternative access points
Financial education and consumer protection	Continued implementation of the multi-dimensional Economic and Financial Learning Program	Disseminate public information through campaigns and consumer education programs on economic and financial issues to promote awareness and understanding of essential economic and financial issues
	Active engagement in global discussions and initiatives on financial inclusion. The BSP currently chairs the Steering Committee of the AFI, a global network of policy makers and regulators committed to financial inclusion.	Enhance promotion of financial inclusion initiatives
Calibrated product offerings for targeted needs	Implemented the Credit Surety Fund*	Increased advocacy for MSME access to finance
	Adoption of rules and regulations regarding derivative products and trading	

AFI = Alliance for Financial Inclusion, BSP = Bangko Sentral ng Pilipinas, MSME = micro, small, and medium-sized enterprise.

***** This provides a maximum of 80% surety cover for loans granted by banks to borrowers that would have difficulty assessing such credit facilities. As of end-December 2012, there are 26 CSFs nationwide with aggregated contribution pledges of P396.621 million, of which P303,284 million has been paid (*PDP Medium Term Update*, Chapter 5).

Source: NEDA (2014).

[6] In the large sense, including microinsurance, payments, savings, and remittances.

Foremost of the push factors are the policy and institutional reforms adopted by the government with the donor community's assistance to create a hospitable environment for microfinance. Private microfinance providers responded by developing suitable delivery techniques and appropriate products. [7] The government (Department of Finance-National Credit Council and Bangko Sentral ng Pilipinas) and donors collaborated to develop a regulatory framework conducive for microfinance. The developments in Philippine microfinance are nested within a global setting where governments and donors alike are seeking various ways to expand financial inclusion. Accessibility of information and demonstration of successful and failed experimentations in microfinance were important learning sources for the microfinance community in the Philippines. The international donor community, enthused by the successful experiences of microfinance institutions in various parts of the globe in reaching out to low-income clients, invariably included microfinance in their development assistance strategies to the Philippines as an instrument for financial inclusion.

In 1997, the United States Agency for International Development (USAID) provided crucial technical assistance to the Department of Finance-National Credit Council under the Credit Policy Improvement Project (CPIP). International and Filipino experts were made available to advise the government and the emerging microfinance community on effective global microfinance practices. The CPIP laid down the policy, regulatory, and institutional framework that resulted in the current notable performance of the microfinance sector. The CPIP was instrumental in providing good policy advice to the government with the following major reform measures benefiting from the technical assistance: National Strategy for Microfinance, Executive Order No. 138, credit policy provisions in the Agriculture and Fisheries Modernization Act, microfinance provisions in the General Banking Act of 2000, and the Social Reform and Poverty Alleviation Act. From the CPIP came the advice to use risk-based supervision of microfinance institutions instead of the traditional, collateral-based supervision then employed by the regulator. The General Banking Act of 2000 and the National Strategy for Microfinance provided the regulatory framework for proportionate regulation and risk-based supervision adopted by the Bangko Sentral ng Pilipinas for microfinance.

A companion technical assistance was also given to the credit-granting nongovernment organizations (NGOs). In 1997, a group of local NGOs organized themselves into the Coalition on Performance Standards to strengthen their respective organizations through adherence to certain benchmark performance ratios. The Coalition on Performance Standards later morphed into the Microfinance Council of the Philippines. How to achieve the goals of financial and operational sustainability while expanding coverage or outreach to targeted, small-scale clients became the primary objective of those credit-granting NGOs. The result was to make performance ratios part of the regular reports made by MFIs to their respective board of directors or trustees and donors. Donors also helped the emerging microfinance sector in the Philippines through cheap loans, grants, and technical assistance. [8] Official development

[7] The discussion in this section does not provide an exhaustive list of such factors, but dwells on those that are deemed to be the most critical in the development of the microfinance sector.

[8] An example is ADB's Rural Microenterprise Finance Project (Loan 1435-PHI). According to the evaluation of the project done in July 2006, "the Project demonstrated that the Grameen Bank approach could be implemented successfully nationwide. Notably, by facilitating the participation of rural banks, cooperative rural banks, and thrift banks that have emerged as major microfinance providers, the Project brought microfinance into the mainstream of the financial system. The favorable policy and legal environment, catalytic role of the Project in expanding the supply of microfinance services, and flexibility of the Project to respond to changing market needs contributed greatly the Project's success." ADB and

assistance (ODA) funds performed the critical function of demonstrating that microfinance was both socially beneficial and profitable (the double bottom line). With success came more funding, this time from local commercial sources, private donors, and international foundations.[9]

Another push factor in the early days of microfinance was the realization on the part of the government of the failure of subsidized or directed credit programs (DCPs) in reaching the intended targets, mostly small farmers and other small-scale clients, in a sustainable manner. The fiscal cost of funding 63 DCPs, representing 73% of DCPs implemented by various government agencies, was as much as 1.8% of gross national product (GNP) in 1996.[10] The bulk of the funding came from foreign loans. Data from 24 reporting DCPs for the 2 years from 1995 to 1996 showed a total of 685,794 borrowers, an average of 29,000 borrowers per program. Of the 86 reporting DCPs, 49% had an average repayment rate of 82.6% in 1996, slightly lower than the 1995 figure of 83.9%. Some DCPs reported repayment rates of lower than 60%. There was limited outreach because of the lack of an efficient delivery mechanism, low turnaround of loanable funds considering low repayment rates, and poor monitoring (Llanto, Geron, and Tang 1999). With CPIP advice, the government decided to terminate those DCPs and encouraged a market-based approach to microfinance with private financial institutions taking the lead in developing appropriate products for the excluded.

The government undertook a series of major reforms as mentioned above. Both the national government and the financial regulator took pains to understand microfinance and work toward proportionate regulation of the sector. The regulators became open to new and innovative microfinance techniques, and allowed experimentation and innovations but with an eye to financial stability. The microfinance industry, regulators (Insurance Commission, Bangko Sentral ng Pilipinas) and an oversight agency (the National Credit Council) collaborated toward proportionate regulation and effective monitoring of operations. Proportionate regulation and risk-based supervision were adopted by the Bangko Sentral ng Pilipinas, and from this regulatory stance arose a stream of regulations that sought to enhance the capacity of MFIs (rural banks, thrift banks, mutual benefit associations) to provide financial services to small-scale clientele without jeopardizing financial stability.[11]

The principal donor to develop microinsurance was the ADB-Japan Fund for Poverty Reduction (JFPR), which provided assistance from 2008 to 2012 through the Developing Microinsurance project (ADB-JFPR Grant 9118). There were other donors to the microinsurance sector. German Agency for International Cooperation (GIZ) assistance was made through the Microinsurance Innovations Program for Social Security implemented by the Insurance Commission. The Rural Bankers Association of the Philippines received a grant from the International Labour Organization's Microinsurance Innovation Facility to assist rural banks in becoming microinsurance

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the IFAD both funded programs designed to provide Philippine MFIs with loans, grants, and technical assistance (ADB 2006).

[9] Some local examples are the following private entities. Banco de Oro is an important donor to the local MFI community while the Ayala Group, a big financial conglomerate, created a foundation and later a bank that is oriented to provide mobile financial services to poor households and microenterprises.

[10] The survey conducted by Llanto, Geron, and Tang (1999) covered 86 directed credit programs, of which data were shared by only 63.

[11] The CPIP brought Filipino legislators, representatives of government financial institutions, and government officials to an educational study visit of exemplary Latin American MFIs in Guatemala, Peru and Bolivia in 1999. The learnings from the study visit informed the subsequent legislation that recognized microfinance as a legitimate banking activity to be supervised by the BSP and motivated the regulator to have proportional regulation as its regulatory stance.

agents. The World Bank's First Initiative Project provided the Insurance Commission with technical assistance to enhance its financial reporting framework using information and communication technology (ICT) as a tool (Department of Finance 2012). The blueprint for the development of the microinsurance sector, namely the Regulatory Framework and the National Strategy for Microinsurance, was developed in 2009 with donor technical assistance.

Thus, the present situation where the government, the financial regulators, and the private sector (rural banks, cooperatives, and microinsurance providers) are collaborating to expand financial inclusion compares starkly with the situation in the late 1960s to the 1980s when it was chiefly a government effort to provide low-income sectors with access to cheap credit. The main strategy then was the use of preferential credit allocation to target groups at highly subsidized rates (Llanto, Geron, and Tang 1999; Llanto 2005; Esguerra 2012). In the 1980s and 1990s, a motley group of small NGOs started to provide microenterprises with microcredit and informal savings services. Today, in addition to regular banks and MFIs, other financial service providers and micro-banking offices have become important access points of financial services in areas where branch banking is not available. [12] Meanwhile, the development of appropriate micro products, such as micro-deposits, microenterprise loans, micro-agriculture loans, housing microfinance, and microinsurance guided by proportionate regulation, has provided a broad array of financial products to serve small-scale clients.

Internal factors have contributed to the significant development of the microfinance sector in the past 2 decades. There are many pull factors[13] and a few notable ones consist of the following: (a) a mission-oriented goal of MFIs to provide poor households and microenterprises with access to financial services; (b) the drive toward operational and financial self-sufficiency and the use of effective business models and innovations to sustain microfinance operations; and (c) effective board governance.

A double bottom line of fulfilling a social mission and providing service in a profitable and sustainable manner appears to be a pervasive philosophy among MFIs in the Philippines. The failure of various government subsidized credit programs spurred local NGOs and credit cooperatives to fill the gap by reaching out to the large population of small-scale clients. Armed with a better understanding of local communities and effective business models and lending techniques, MFIs (initially NGOs and later rural banks with microfinance operations) registered expanding outreach and loan repayment rates of as high as 98%. They demonstrated that fulfilling a social mission can be done without sacrificing financial viability. Meanwhile, in the insurance sector, low-income clients had to settle for informal "insurance" against various risk events because of the failure of the government and the private insurance sector to include them in mainstream insurance. Unfortunately, those informal schemes proved inadequate against catastrophic losses. Again, a sense of mission among mutual benefit associations and credit cooperatives motivated them to develop better insurance products in coordination with the Insurance Commission.

MFIs use effective business models that are very important to ensuring their financial viability, including tested loan collection techniques and monitoring schemes. They started with the Grameen Bank model of group lending with a joint liability arrangement, looked at the solidarity group models pioneered by Latin American

[12] Other providers include non-stock savings and loans associations, credit cooperatives, pawnshops, and other nonbank financial institutions, remittance agents, money changers/foreign exchange dealers and e-money agents. Micro-banking offices are scaled down branches that perform limited banking activities, e.g., accepting micro-deposits and releasing micro-loans to microfinance clients.

[13] These could vary across MFIs.

NGOs, and later used the Association for Social Advancement's (ASA) modified Grameen approach of group lending but without a joint liability requirement to expand outreach and maintain loan collection efficiency. Internally, many MFIs have resolved to adhere to the performance standards initially developed by the Coalition on Performance Standards and influenced by CGAP guidelines on performance and governance. The board of trustees/directors and international donors to those MFIs closely monitor the performance of the MFIs, which submit regular reports on performance, e.g., significant financial ratios during a reporting period (Table 9).

Another major internal factor explaining the development of the microfinance sector is the quality of governance of the MFIs. Governance of MFIs as an essential component of long-term institutional success has only recently surfaced (Otero 2009). It is a critical factor for the success and sustainability of microfinance institutions. This is understandable in view of the mainstreaming of microfinance and the transformation of credit-granting NGOs into regulated institutions. As MFIs assume an important role in the financial system, serving a greater number of the population with financial services, they have to maintain "high standards of performance, and necessitating increased inputs and involvement by the board to ensure effective management" (Campion and Frankiewicz 2009: 1). The board of directors of microfinance-oriented banks in the Philippines has to pass the "fit-and-proper" rule imposed by the BSP that requires directors to have professional competency, integrity and moral fitness to qualify as such. The board directors have generally complied with this requirement by undergoing seminars/trainings on corporate governance to prepare themselves for their tasks, and have also complied with the BSP's requirement of annual performance rating of board directors. As a result, effective board governance has enabled the regulated MFIs to expand and sustain microfinance operations.

Table 9: Some Financial Ratios Monitored and Reported by Microfinance Institutions in the Philippines

Significant Financial Ratios		Industry Ratio, as of Current Month*	Target	Current Month/Year	Previous Month/Year
Solvency					
1	Capital Adequacy Ratio (CAR)	16.11%	Greater than		
2	Total capital to total assets	11.40%	Greater than		
3	Debt to Equity Ratio	12.75%	Less than		
4	Past due loans and ITL to total loans and discount	5.18%	Less than		
5	Total classified loans and discount to total loans	2.30%	Less than		
Liquidity					
1	Loans and discount (gross) to deposits and borrowings	81.86%	Greater than		
2	Loans and discount + investment (gross) to deposits and borrowings	83.83%	Greater than		
3	Deposits to capital	720.23%	Equal or greater than		
4	Primary reserves to deposits	21.60%	Greater than		
Profitability					
1	Total expenses to gross earnings for SME banks	55.34%	Less than		
2	Total expenses to gross earnings (microfinance banks)	74.73%	Less than		
3	Net income after tax to average capital return on equity	6.85%	Greater than		
4	Net income after tax to average assets return on assets	0.85%	Greater than		
5	Net interest margin to average earning assets for SME banks	5.28%	Greater than		
6	Net interest margin to average earning assets microfinance banks	9.76%	Greater than		

ITL = items in litigation; SME = small and medium-sized enterprise.

* Sample industry ratios computed as of 30 June 2014.

Source: Author's compilation.

2.6 Obstacles to Further Progress in the Microfinance Sector

A major obstacle to further progress in the microfinance sector is political intervention. Politicians, sensing a good way to boost political capital, could start to tinker with the evolving microfinance architecture that has worked so well for the country. They can provide substantial funding to MFIs in exchange for political favors, propose populist legislation that can undo the major reforms earlier discussed, or even revoke good policy. An example was an attempt by a previous administration to revoke Executive Order No. 138 that terminated directed credit programs. A compromise solution was to retain Executive Order 138, but to allow direct lending by a government line department in areas allegedly not currently served by any MFI. The problem with the compromise is that it denies the MFI an incentive to locate in those areas precisely because of government direct intervention. Those areas will therefore remain dependent on government injection of cheap funds. Policy inconsistency can retard further progress in the microfinance sector.

The lack of proper understanding of client needs, unaddressed socioeconomic and cultural factors, and barriers posed by geography, information, and coordination problems can also be significant hurdles for further growth of the sector. Inadequate physical infrastructure, such as bad roads, inefficient transport, and shipping facilities, as well as problems with access to efficient telecommunications services, exacerbate the problems posed by geography.

The slow implementation of a credit information system that is intended to overcome the lack of formal financial history of clients is also an issue. In 2008, the Credit Information System Act was passed creating the government-owned Credit Information Corporation (CIC) to oversee the provision of positive and negative credit data on borrowers that banks can use as a basis from releasing loans and repayment interest rates. [14] Banks, quasi-banks, and their subsidiaries and affiliates, life insurance companies, credit card companies, and other entities are required to submit basic credit data and updates thereon on a regular basis. The CIC may include other credit providers to be subject to compulsory participation. All other accessing entities may participate subject to acceptance by the CIC.[15] However, for a variety of reasons, the CIC has barely managed to implement its mandate. In fact, it has only just recently started deliberating on the kind of information technology system that will become the backbone of the credit information database (Gamboa 2012).

3. FINANCIAL EDUCATION

The Philippine Development Plan 2011–2016 provides a blueprint for a resilient and inclusive financial system. It seeks (i) the establishment of a regulatory environment that balances financial inclusion objectives with financial stability goals; (ii) the promotion of use of alternative products and delivery of financial services in underserved and unserved areas of the country; (iii) the promotion of financial literacy and consumer education; and (iv) the continuing development of new loan products and other banking services aimed to address the special needs of the poor, women, and persons with disabilities.

For its part, the Bangko Sentral ng Pilipinas has (a) an Economic and Financial Learning Program to promote greater public awareness of economic and financial issues and provide information to enable households and businesses to make well-informed economic and financial decisions; and (b) a Credit Surety Program, which creates a trust fund from the contributions of a provincial government and a cooperative in the same province to encourage financial institutions to lend to MSMEs in the province using the surety cover as a collateral substitute (NEDA 2014). The Economic and Financial Learning Program (EFLP) is the BSP’s umbrella program for economic and financial education in the country, consisting of various learning sessions designed and targeted for specific audiences like schoolchildren, secondary and tertiary students, overseas Filipino workers, microfinance clients, and others. The EFLP does not seem to have financial literacy programs for small enterprises. Box 2 shows the 2013 milestones of the EFLP.

[14] CiC was created in 2008 by virtue of the Republic Act. No. 9510, otherwise known as the Credit Information System Act (CISA).

[15] For details, see the CIC website: http://creditinfo.gov.ph/frequently-asked-questions

Box 2: 2013 Economic and Financial Learning Program Milestones

- Since the EFLP's implementation in 2010, 26 EFLP roadshows have been conducted in key cities and municipalities.
- A cumulative total of 38,000 participants have benefited from EFLP sessions.
- In 2013, five EFLP roadshows were done in five provinces.
- In 2013, the BSP in coordination with the Overseas Workers Welfare Administration conducted training for lecturers and providers of pre-departure orientations to overseas workers prior to deployment abroad.
- With support from the World Bank, the BSP commenced preparatory work for a baseline survey to assess financial capability and literacy.
- A total of 29 Credit Surety Funds have been established in 22 provinces and 7 cities; from the inception of Credit Surety Funds in 2008 to November 2013, cumulative approved loans for 7,135 clients reaching P909 million have been registered.
- The BSP authorized 12 banks to conduct deposit taking activities in school premises; over 400,000 new accounts were opened in 2012–2013.

BSP = Bangko Sentral ng Pilipinas, EFLP = Economic and Financial Learning Program.

Source: BSP (2013).

The National Credit Council (NCC) and the Insurance Commission oversee financial education covering microinsurance in collaboration with the National Anti-Poverty Commission. Financial literacy training, seminars, and workshops on microinsurance are separately conducted for providers of microinsurance and clients, respectively. The financial literacy modules for financial services providers focus on their responsibilities to clients and the various prudential, market conduct, and good governance requirements, while the module for clients centers on the rights and responsibilities of the insured (National Credit Council Secretariat 2010).

The BSP, NCC, and the Insurance Commission have done creditable pioneering work on financial education. Financial education should not just be the responsibility of the central bank for microfinance, or the NCC or the Insurance Commission for microinsurance. At stake is greater financial inclusion of the excluded segments of the population, which faces serious obstacles. The banking system, and particularly MFIs, should take a greater interest in financial education to help expand outreach, improve the quality of financial services, and in effect, help businesses grow. The double bottom line espoused by MFIs is more easily achieved with an effective financial education program.

A major issue is delivery of the financial education program to a wider audience. The BSP, NCC, and the Insurance Commission do not have the delivery structure for such an important program. It will be useful to harness the school system (primary, secondary, and tertiary levels) and civil society for a more comprehensive coverage of financial education. There is a need to incorporate financial education into the school curricula.

A crucial element of financial education is consumer protection. The BSP has acknowledged that "financial inclusion ushers the participation of clients that are less sophisticated and generally more vulnerable to predatory finance" (BSP 2013). It is imperative that consumers, especially low-income clients, are properly educated on their consumer rights and are given proper access to complaints desks of financial institutions and the BSP Financial Consumer Affairs Group.[16] Too often, financially illiterate individuals have been the unwary victims of various finance scams that have been perpetrated by unscrupulous individuals and companies.[17] Micro and small enterprises also stand to benefit from financial education but are not currently covered in current financial literacy programs.

4. FINANCIAL REGULATION AND SUPERVISION OF THE MICROFINANCE SECTOR

A market-based financial ecosystem was just the right environment for the microfinance sector to grow and develop. The current vibrancy of the microfinance and microinsurance markets in the Philippines is basically due to the reforms pursued by the government and regulators in collaboration with private sector stakeholders that led to a greater private sector role, chiefly by MFIs, in providing credit, deposit services, and other services to low-income sectors. There are several types of MFIs in the Philippines: rural banks, cooperatives, credit cooperatives, and credit NGOs. Only rural banks and credit cooperatives are allowed to accept deposits.

Proportionate regulation adopted by the BSP toward microfinance provided the necessary impetus for growth and development of the sector. This meant adjusting prudential norms, basically covering capital requirements, loan provisioning, reporting and loan documentation, among others, to conform to the specialized character of microfinance. CGAP (2012) pointed out that some prudential norms developed for conventional banking have no fit with the risks and requirements of microfinance, which involve different products and services. The different BSP circulars indicate how the regulator has adjusted regulation and supervision approaches to enable MFI banks to expand outreach (financial inclusion), while at the same time protecting microfinance depositors and promoting the safety and soundness of the microfinance institution. To have proportionate regulation means taking into consideration the following features of microlending methodology used by MFIs and adjusting prudential norms: low initial loan sizes, with gradually larger amounts available in subsequent loans; loan appraisal based on personal contact rather than scoring; group lending or individual lending based on analysis of the borrower’s likely cash flow; and an understanding that borrowers who repay their loans will have access to follow-on loans (CGAP 2011). Proportionate regulation means that costs are proportionate or balanced to the risks and benefits of regulation. It seeks to achieve a desired level of financial inclusion, while maintaining financial system stability (Grady and Waller 2012).

As practiced in the Philippines, traditional bank supervision applies standardized procedures and focuses on individual transactions and the adequacy of loan collateral. Banking regulations do not prohibit the granting of small clean loans. However, in practice there has been a regulatory bias against the granting by banks of loans with insufficient collateral or without any form of security or collateral. Since microfinance loans are typically given without collateral, there is a risk that examiners will criticize

[16] On a daily basis, the BSP Financial Consumers Affairs Group processes 7–29 complaints, inquiries, or requests, 90% of which are resolved within 3 banking weeks. Simple complaints are resolved within 2 banking days according to the BSP Financial Inclusion Initiatives 2013.

[17] An example is the Aman Futures Group money scam that duped about 15,000 investors from Visayas and Mindanao in 2012. The pyramid scam, dubbed one of the biggest in the country's history, is estimated to have robbed investors of P12 billion worth of hard-earned cash. http://www.rappler.com/nation/16934-timeline-the-aman-futures-pyramid-scam

banks making such loans. This could constrain the expansion of microlending and disadvantage low-income clients (Llanto 2001). The attitude of bank examiners has changed with the adoption by the BSP of risk-based supervision for microfinance banks. At present, the regulators (BSP and the Insurance Commission) examine how MFIs and microinsurance providers, respectively, identify, manage, control, and monitor risks in an appropriate and timely manner. The regulator is more concerned with a broad spectrum of risks, e.g., credit risk, liquidity risk, operational risk, reputational risk, interest rate risk, among others, and how the MFI deals with them rather than with documentation, such as the loan collateral behind loans. A risk profile of the MFI bank presents a good starting point in assessing financial conditions and performance (Llanto 2001). Thus, BSP circulars require MFI banks to observe conditions for safe and sound banking practices, risk management, internal control systems, and provisions for probable losses.

Both proportionate regulation and risk-based supervision of microfinance require a cultural change on the part of the regulators, which have relied on traditional approaches to regulation and supervision to assess the financial health of institutions. In this regard, new and innovative ways that use emerging technologies to foster financial inclusion have emerged. The use of mobile phone banking is one such mechanism. ESCAP (2014) observed that ICT use has supported the rollout given an estimated 60% mobile phone penetration in the Pacific versus mobile phone penetration of under 10% in 2006. Mobile banking solutions will require appropriate regulatory and supervisory approaches to ensure the integrity of financial services and financial stability. A survey conducted by the Technology and Business Model Innovation Program of the CGAP found that at the end of 2011, there were 148 active branchless banking businesses worldwide, 26 of which had more than 1 million customers.

The Philippines has been particularly successful with mobile phone based models (ESCAP 2014). E-money regulations enabled the entry of new providers and more active agents, an exponential increase in e-money accounts, and an incremental buildup of transactions. Branchless banking that combines the use of retail agents and ICT to deliver financial services has also been used in the country to surmount problems of geography and inaccessibility of poorer clients. Branchless banking is at an infant stage and needs careful nurturing and tweaking to make it an effective, safe, and innovative way to reach the unbanked. There seems to be a regulatory gap in the sense that regulators are still groping for the most appropriate way to regulate those technology-enabled financial services. The challenge faced by regulators, including the BSP, is to “define the role of mobile network operators and other actors not previously subject to financial regulation and supervision” (Ehrbeck, Pickens, and Tarazi 2012). Box 3 illustrates the issue and how the BSP dealt with it.

Box 3: Bangko Sentral ng Pilipinas as an Enabler

Several years ago, the regulator was presented with two e-money schemes. One e-money product, Smart Money, was issued by a bank. The other, Gcash, was issued by a non-bank subsidiary of Globe Telecom, one of the largest mobile network operators in the Philippines. Although Gcash introduced a non-bank actor into what had been seen as the domain of licensed banks, the BSP chose to open the door to an innovative product with the potential to reach unbanked populations. Using its rule-making power as the payment system overseer, BSP approved each model on an ad hoc basis, but only after confirming that each model mitigated identified risks. Based on its observations of the market's development over more than 4 years, BSP issued e-money regulations in 2009 (BSP Circular 649, issued on 9 March 2009). The regulations are notable for regulating e-money as a service and not by the legal character of the e-money issuer, while still imposing conditions to mitigate the risks presented by non-bank e-money issuers. The regulations effectively created a level playing field between banks and non-banks, ultimately enabling a greater array of actors and products with the potential to promote financial inclusion.

BSP = Bangko Sentral ng Pilipinas.

Source: Ehrbeck, Pickens, and Tarazi (2012).

In this regard, Erhberck, Pickens, and Tarazi (2012) suggest proper support for the development of both front-end infrastructure (the point of contact with customers, including ATMs, point-of-sale [POS] devices, and retail agents of financial services providers) and back-end infrastructure (the backbone needed for efficient financial services, including payment switches, credit bureaus, and collateral registries).

On the part of the Insurance Commission, the Regulatory Framework for Microinsurance established the policy and regulatory environment that will encourage, enhance, and facilitate the safe and sound provision of microinsurance products and services by the private sector (National Credit Council Secretariat 2010). The active collaboration between the Department of Finance, the Insurance Commission and the insurance community was critical in the adoption of proportionate regulation toward microinsurance. Proportionate regulation led to the formalization of various informal insurance schemes that MFIs had provided to clients ("members" in the language of NGOs). To protect their loan portfolios and at the same time provide some form of risk protection to vulnerable low-income clients, MFIs in the Philippines have devised informal "microinsurance" schemes such as in-house mutual aid or benefit funds, "credit life insurance," and other similar schemes, provided mostly by cooperatives and NGOs (Llanto 2007). About half of the 22,000 operating cooperatives in the country provided some form of insurance to members through "mutual fund schemes" (Llanto, Geron, and Almario 2008). These schemes are neither regulated nor licensed by the Insurance Commission (Department of Finance 2012). Drawing those informal schemes into a formal regulatory framework was necessary to protect consumers and build trust in insurance, whose image and reputation have suffered because of fraudulent behavior in the past by a few insurance and pre-need companies.

It seems that proportionate regulation has worked for the microfinance sector. It has enabled the sector to evolve innovative approaches to financial inclusion. However, as the microfinance sector grows in coverage and diversity of financial products and services offered to low-income clients, e.g., mobile payments and remittance services, and as innovative ways of service delivery, e.g., through MBOs, are developed, there is a great need to deepen understanding of the risks created in fostering "light touch" regulation, and find ways to manage those risks. For example, MBOs are not required to have vaults for safekeeping nor security guards in the premises as regular banks are. There is a need for closer monitoring and more efficient information systems for MFIs and regulators as well to ensure financial integrity and stability. It is noted, though, that the loan portfolios of MFIs are not as concentrated as those of commercial banks. Credit risks and other risks are well-distributed and thus the failure of an MFI bank (a relatively small rural bank) does not impact adversely on the financial system as a whole. MFIs do not seem to pose systemic risk unlike the domestic systemically important banks (e.g., universal banks) whose closure would adversely impact on the economy. [18] What is at risk though is the reputation of microfinance from the perspective of small depositors, especially those who have hitherto been excluded. Failure or closure of MFI banks will impact on the willingness of small depositors to participate in the mainstream financial system. There is a need to carefully balance the proportionate regulation of banks engaged in microfinance with the need to protect financial integrity and stability of those banks.

5. CONCLUSION AND POLICY RECOMMENDATIONS

The Philippine experience with microfinance shows the essential role played by a conducive policy and regulatory framework in motivating private financial services providers in making innovative financial products and services accessible to the poor. Financial deepening among the excluded segment of the population has started to take root. Financial inclusion has started to expand, but there are challenges facing policymakers and regulators as well. Financial education also has a critical role in financial inclusion. This should include a program of financial education for SMEs because small firms present great opportunities for inclusive growth.

The primary challenge faced by the government is defining its role in creating broader and more interconnected ecosystems for safe and efficient product delivery to the poor (Ehrbeck, Pickens, and Tarazi 2012). The regulators (BSP and the Insurance Commission) have maintained a proportionate regulatory stance, which allows for experimentation and pilot testing of approaches that could promote financial inclusion. They are concerned as well with the need to maintain the financial health of deposit-taking financial institutions (banks) and microinsurance providers and to ensure financial stability. [19] The government has so far largely resisted the temptation of directly participating in the microfinance market despite a recent attempt to go back to directed credit programs. However, there is always the risk that politicians may sponsor credit programs funded by public monies to meet certain sociopolitical objectives. The microfinance community should be vigilant about such attempts to weaken the market-based microfinance ecosystem that has so far shown to be a workable approach to financial inclusion.

Nevertheless, deep challenges remain, and in this light, the following policy recommendations are proposed.

- There is a need for the BSP, NCC, and the Insurance Commission to undertake financial education in cooperation with the school system at all levels: primary, secondary, and tertiary. There is also a role for civil society in promoting financial education.

[18] BSP has classified at least 14 domestic banks as "domestic systemically important banks."

[19] Although there is general consensus on the need for a favorable policy environment for microfinance, there is no current consensus on how to create this environment (Ledgerwood and White 2006).

- Financial education should be incorporated into school curricula. Related to this is the importance of establishing a program of financial education for SMEs.
- Banks, in collaboration with the BSP, should work on a regular reporting format for SME access to formal loans.
- There is a need for more effective enforcement of consumer protection and this could be promoted through financial education for low-income clients.
- There is a need to support and make the Credit Information Corporation fully operational as soon as possible. It needs good staff and substantial resources to accomplish its mandated tasks.
- There is merit in developing appropriate regulation and supervision of mobile banking and various types of financial innovations for fostering financial inclusion. There is a need to balance the expansion of financial inclusion through emerging technologies and ensure the stability of the microfinance sector.
- The government and regulators should support the development of back-end infrastructure, that is, the backbone needed for efficient financial services, including payment switches, credit bureaus, and collateral registry.

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