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Philippines

Country-Level Savings Assessment

CGAP Savings Initiative

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Abbreviations

ACPC	Agricultural Credit Policy Council
ATM	Automatic Teller Machine
BAP	Bankers Association of the Philippines
BSP	Philippine Central Bank
CDA	Cooperative Development Authority
CFO	Commission on Filipino Overseas
CTB	Chamber of Thrift Banks
CUES	Credit Union Empowerment & Strengthening Project
DCP	Directed Credit Program
FOCCUS	Finance Organisations Achieving Certified Credit Union Standards
JBIC	Japan Bank for International Cooperation
KfW	*Kreditanstalt für Wiederaufbau* (German Development Bank)
MABS	Microenterprise Access to Banking Services
MCPI	Microfinance Council of the Philippines, Inc.
MFI	Microfinance Institution
NATCCO	National Confederation of Credit Cooperatives
NCC	National Credit Council
NEDA	National Economic Development Authority
NSCB	National Statistics Coordination Board
RBAP	Rural Bankers Association of the Philippines
ODA	Overseas Development Assistance
OFW	Overseas Filipino Workers
ONB	One Network Bank
PCFC	Peoples' Credit and Finance Corporation
PCHC	Philippine Clearing House Corporation
PDIC	Philippine Depository Insurance Corporation
PFCCO	Philippine Federation of Credit Cooperatives
PhP	Philippine Peso
PHPF	Philippines Homeless People's Federation
PIDS	Philippine Institute for Development Studies
PNSO	Philippine National Statistics Office
QUEDANCOR	Quedan and Rural Guarantee Corporation
SEC	Security and Exchange Commission
SRT	Self-Reliant Teams
UNDP	United Nations Development Program
WOCCU	World Council of Credit Unions

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Executive Summary

This report summarizes the results of the second test of CGAP's Country Savings Assessment Toolkit, which took place in the Philippines. The purpose of the toolkit is to help government agencies, donors, and others identify opportunities and constraints in increasing poor people's access to high-quality deposit services in various countries. The methodology examines four levels of the financial system: clients, financial institutions (micro), supporting infrastructure (meso), and policy (macro). It concludes with suggestions for possible strategies to improve the quality and quantity of deposit services available to poor and low-income households.

Despite a widespread belief that poor Filipinos do not save, the review team found substantial anecdotal evidence that savings capacity does exist among low-income clients. Research on savings behavior (although scarce) confirmed the existence of savings practices among the poor. Rapid growth in deposits by institutions that have made concerted efforts to reach poor clients also reinforced the idea of significant latent demand. Another potential source of savings—remittances—has begun to spur even mainstream banks to target low-income clients.

At the micro level, a variety of institutional types serve different market niches. However, deposit products appear to be unaffordable and physically inaccessible to the poorest clients, and those institutions closest to the poor also demonstrate the weakest performance. At the meso level, plentiful donor-funded credit lines, excess liquidity in the banking system, and a lack of investment opportunities, all reduce the incentives for stronger institutions to collect small deposits. An underdeveloped financial infrastructure, such as payment and liquidity management systems, pose further obstacles for some financial institutions. However, new mobile phone banking applications offer a cost-effective, accessible way for institutions to process low-value payments. At the macro level, although the government's commitment to market-led microfinance and the overall regulatory structure facilitates serving low-income clients, certain overly conservative operational restrictions may limit the outreach of regulated institutions. In the meantime, cooperatives suffer from an almost total lack of oversight.

In light of these findings, the following nine areas could provide promising avenues for intervention to improve the mobilization of small-balance deposits in the Philippines.

1. **Collect more data** on clients' savings patterns and preferences to inform policy debates and support the business case for small-balance savings mobilization.
2. **Expand financial literacy** efforts for residents, leveraging experiences with Overseas Filipino Workers and their families.
3. **Institutionalize and expand successful technical assistance programs** on a sustainable basis to ensure their effectiveness beyond the life of any single donor project.
4. **Build on existing monitoring systems and rationalize ratings** to enhance transparency and client confidence.
5. **Evaluate alternative electronic banking and payment services** for rural banks and cooperatives to increase poor clients' access to savings accounts and money transfers.
6. **Strengthen financial cooperative supervision** to better ensure the safety and soundness of poor people's money.
7. **Re-evaluate the need for program loan funds**, and continue phasing out directed credit programs as part of a strategy of incentives for large-scale small deposit mobilization.
8. **Shift the supervisory framework for banks** from operational restrictions toward risk-based supervision to better balance the twin objectives of control and access.
9. **Update the national microfinance policy** to more fully incorporate deposit mobilization.

Introduction

This report summarizes the results of CGAP's country-level savings assessment in the Philippines. The assessment was conducted to test a Country Savings Assessment Toolkit under development as part of CGAP's Savings Initiative.[1] The purpose of the toolkit is to help government agencies, donors, international networks, and technical service providers define potential strategies for increasing poor people's access to high-quality deposit services.

The toolkit examines evidence on demand for deposit services among poor populations, and identifies opportunities and constraints to meeting that demand. It examines three levels of the financial system: 1) the capacity for small-deposit mobilization among financial service providers ("micro" level); 2) financial infrastructure and second-tier support for the micro-level institutions to reach scale ("meso" level) and 3) public policies and government entities that create an enabling environment (or not) for savings mobilization ("macro" level). It concludes by identifying promising strategies to improve the quality and quantity of deposit services available to poor and low-income households.

The assessment draws on 1) analysis of existing studies and information on demand levels, institutional capacity and the macro environment in the Philippines (see Annex II for sources compiled on savings in the Philippines); 2) interviews with some 90 informants related to small-deposit mobilization in the Philippines during the in-country assessment carried out April 24 to May 7, 2005 (see Annex II for the list of informants) and 3) visits to financial institutions to collect information on savings products.[2]

Defining Savings: Poor people save in various forms—financial and non-financial, formal and informal. The focus of the assessment is on formal financial savings, defined as non-compulsory liabilities that come from clients.

[1] For further information on CGAP's Savings Initiative and information on savings mobilization, visit the CGAP Savings Information Resource Center (SIRC) at www.cgap.org/savings.

[2] The assessment team was comprised of Isabel Dauner Gardiol, consultant; Jenny Hoffman, consultant; Brigit Helms, Lead Microfinance Specialist at CGAP; and Rani Deshpande, Microfinance Analyst at CGAP. Visits to financial institution branches were done by Eo Masilungan from AIM, who also helped organize the mission, and Jennie de Leon from CARD.

Overview of Savings in the Philippine Economy and Financial System

The Philippines has a relatively developed financial system and a highly monetarized economy, with a ratio of savings in banks/GDP of 75 percent (see data in table 1). The ratio of bank loans to private sector/GDP is 50 percent, indicating excess liquidity in the banking system, which pulls down market interest rates. As of May 2005, the 91-day Treasury bill rate was 5.8 percent, several points less than inflation.

Box 1: Economic Situation of the Philippines

In 2004, the Philippines' GDP grew by 6.1%, its highest rate since 1996. This growth was attributed to increased production in industry and services driven by growth in exports and investment, which largely offset a slowdown in consumption spending. Inflation was 8.5% in March 2005, higher than the BSP's 2005 target range of 5-6%, mainly due to supply factors related to rising global oil prices. At the time of writing, future monetary policy was expected to remain oriented towards reducing inflationary risk and keeping prices stable. The Business Expectations Survey (BES) for the first quarter of 2005 showed business optimism attributable to higher market demand in the country and abroad, a stronger peso, political and fiscal reforms and higher tourist arrivals.

Source: BSP (May 2005) and Economist Intelligence Unit (May 2005)

Bank liquidity can be traced partially to the Asian financial crisis of 1997. Although the crisis did not hit the Philippines as strongly as neighboring countries, the country experienced an economic slowdown and a contraction in lending to the private sector. The net loan portfolio of the banking system decreased by 20 percent between 1997 and 2003, reaching $35.04 billion. Meanwhile, the total deposit liabilities increased by 20 percent, to $48.65 billion in 2003.[3]

As of September 2004, the total volume of savings in the Philippine banking system amounted to $46.2 billion. These savings are held in 27 million bank accounts. Assuming that depositors hold between one and two accounts, this would result in 13.5 to 27 million persons or 16 to 32 percent of the population with a deposit account.

Seventy-three percent of these accounts had average amounts below $266 and together make up 2 percent of the savings volume. Meanwhile, only 1 percent of accounts had more than $35,502 but make up 59 percent of the savings volume (see figure 1).

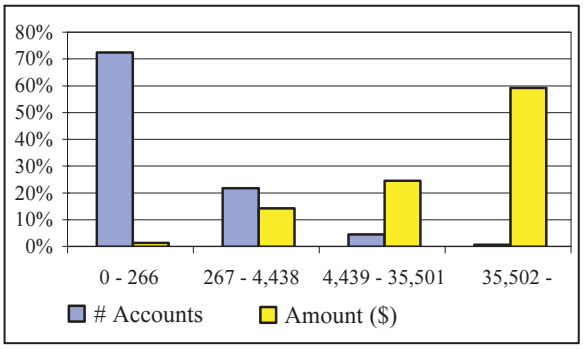
[3] Source: BSP

Table 1: Key economic indicators on the Philippines

Population (2004)	84.2 million
Economically active population (2002)	50.3 million
Total number of households	16.8 million
Total number of accounts in financial institutions	27 million
Total savings in banks (September 2004)	$46.18 billion
National savings rate	17.55%
Savings in banks/GDP	74.8%
Bank loans to private sector/GDP	50.0%
M2/GDP	77%
GDP 2004	$61.7 billion
91-day T-bill rate (May 2005)	5.8%
Inflation (2004)	6%
Average exchange rate for 2004 (PhP/$)	56.09
GNI per capita (2003)	$1080
Legislated daily wage rate of non-agricultural workers	$6.15
% Population on <$2 per day	46.4%
% Population on <$1 per day	14.6%
Total financial institution branches	7,612
Population/Financial institution branch	10,929
Financial institution branch/Million inhabitants	90.4

Source: World Bank, IMF, UNDP, BSP

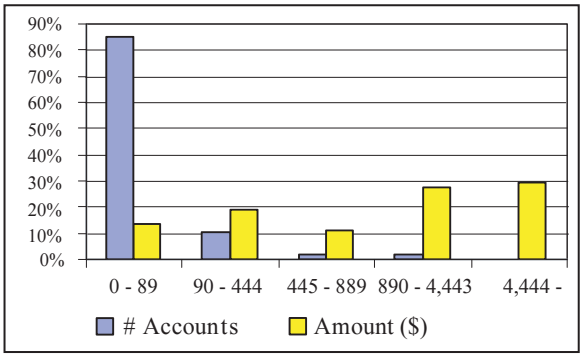
Figure 1: Distribution of savings in the banking system (Sept. 2004)



Source: PDIC

In cooperatives, the distribution of savings account by amount has a similar shape but a much lower modal amount. Over 80 percent of the accounts are smaller than $90 and only 0.3 percent have more than $4,444 (see figure 2).

Figure 2: Distribution of savings in the cooperative sector (Dec. 2004)



Source: CUES

Clients: Demand for Small-Deposit Services

Main finding: Despite widespread skepticism about whether the poor save, available evidence suggests capacity to save among low-income Filipinos.

Interviews revealed a widespread belief that Filipinos are consumption-oriented, with little desire or capacity to save. Rather, Filipinos are thought to use credit for daily needs. Bankers reported that salary deposits are typically withdrawn immediately to repay credit or pay outstanding bills. In return for a cash advance, some pawnshops accept clients' ATM cards and PIN codes, which they then use to withdraw repayments directly from clients' accounts on payday. In addition "kiting," or using one source of credit to repay another, seems to have become a problem in certain areas.

However, substantial anecdotal evidence suggests that poor and low-income Filipinos do save, or at least have the capacity to do so. Informal savings mechanisms, like ROSCAs (called *paluwagan* or *dajong*) or stashing money into *alcancia* bamboo poles at home, seem to be widespread throughout the country. Self-help or solidarity groups that conduct savings and credit activities are also common. Other practices also demonstrate savings capacity, such as the widely subscribed "numbers games" (lotteries) that raise millions of pesos through 5-peso tickets.

Although rigorous research on savings behavior and patterns is scant, it suggests that poor Filipinos do save. For example, an Agricultural Credit Policy Council (ACPC) survey of 794 small farmer and fishing households revealed substantial savings on the part of those households who reported saving. Fishing households saved 40 percent of monthly income, while farming households saved 28 percent of monthly income.

Market research by financial institutions provides further evidence that low-income clients do save. A survey by a microenterprise bank in the outskirts of Manila, for example, revealed that 75 percent of respondents had savings in commercial banks. Moreover, the majority of their interaction with banks occurred in the context of saving rather than taking loans.

In contrast, a recent survey[4] in smaller cities of the Philippines finds that nearly two-thirds of people in urban areas keep their savings at home (see table 2). Only 9.7 percent save in rural banks, 2.2 percent in commercial/thrift banks, and 9.4 percent in cooperatives.

Table 2: Where do urban low-income Filipinos save?

Where respondents keep their savings	Percent of sample (multiple response) n=1285
Home	63.5
Rural bank	9.7
Cooperative	9.4
Self-help group	6.7
Commercial bank	2.2
Other	2.3

Source: Karlan et al. (2004b)

Some interviewees attributed the lack of financial savings among low-income Filipinos to intimidation or unfamiliarity with financial institutions. Many indicated that commercial bank staff does not welcome poor clients, who may be more comfortable dealing with rural banks, cooperatives, or informal institutions for their savings needs.

The study by Karlan *et al.* also sheds light on what motivates low-income Filipinos to save. Most people primarily save for emergencies (precautionary motive). The second most important reason for people to save is the education of their children (see table 3). These findings show that low income households in the Philippines need different types of deposit services to address different needs. Accessible, liquid products allow withdrawals at any time for emergencies, while contractual savings products enable them to accumulate money for specific expenses.

Table 3: What do urban people save for?

What do people save for?*	Percent of sample
Emergencies	42.0
Children's education	34.0
Food and daily needs	6.6
Retirement, future of family, marriage	5.9
Capital to start or expand business, buy land	3.4
Housing	2.3
Other	5.8

Source: Karlan et al. (2004b)

*The 16 original categories were aggregated by the authors.

While the few studies available support the notion that the poor do save, perhaps the clearest finding on the demand side is the lack of good publicly available data on client savings patterns, preferences, and behavior. Such studies are crucial for demonstrating and understanding the demand for small-balance savings services, as well as designing appropriate products.

Active savings promotion effectively increases deposits

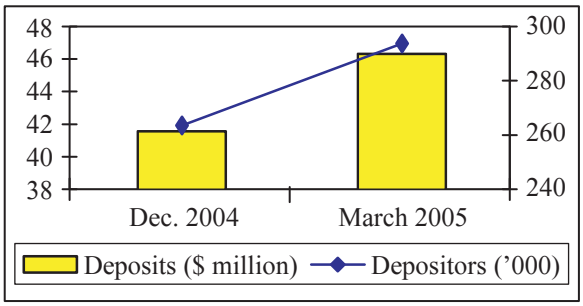
When financial institutions in the Philippines have focused on delivering quality savings services to low-income customers, they have succeeded in tapping latent demand and increasing both their volume of deposits and number of clients. For example, the Green Bank of Caraga offered a group of 710 randomly chosen low-income clients a new commitment savings product (regular saving without withdrawal for a given period), visiting clients door-to-door to promote the product. After 12 months, average savings balances of clients who tried the product increased by 337 percent, while for the control group (clients not included in the experiment), this increase was 80 percent.[5]

[4] Based on a random sample of 1285 persons in major market places in cities of Butuan (North Eastern Mindanao), Baguio (Central Cordillera region), and Bacolod (Negros Occidental). Approximately 70 percent of the sample has incomes below the median household income in the Philippines, which was $166 per month in 2000 according to the PNSO. See Karlan et al. (2004b).

[5] Karlan et.al. (2004a).

In 2004, a merger of three rural banks created One Network Bank with the largest branch network in Mindanao. By actively promoting the image of the new bank as a large, well-managed institution, One Network acquired 23,150 new savings clients and increased the volume of deposits by 11 percent to $46.36 million in only three months (see figure 3).

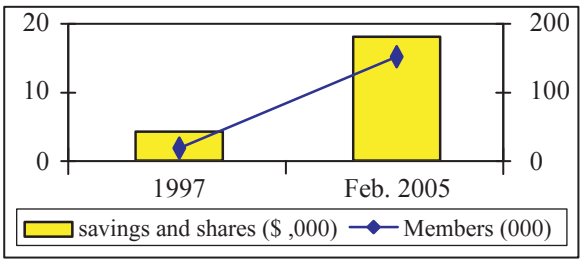
Figure 3: Growth of savings in One Network Bank



Source: ONB

Another example is provided by 10 savings and credit cooperatives, serving mostly low-income clients, which have obtained support from the CUES project (funded by USAID with technical assistance from WOCCU) since 1997. In seven years, these cooperatives more than tripled their savings and shares and increased membership by seven times, reaching 151,314 members and mobilizing $18 million savings by February 2005 (see figure 4). Rural banks participating under the Microenterprise Access to Banking Services (MABS) Program, also supported by USAID, have shown an increase as well in small deposits (under $300) with an increase among the 80 participating banks of more than 237,000 new small depositors since 1999.[6] These positive results have been possible through enhanced financial discipline, stronger administration, and effective marketing campaigns of diversified savings products.

Figure 4: Growth of savings in 10 model cooperatives



Source: CUES.

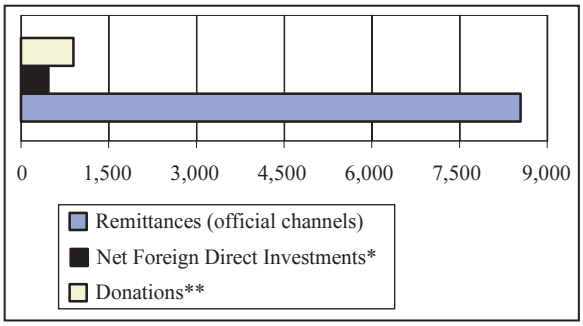
[6] MABS

Evidence shows that low-income households in the Philippines save in financial institutions if they are given an opportunity that meets their needs. Confidence created through an image of a solid financial institution, active savings promotion campaigns, and attractive products are sufficient to mobilize deposits even from low-income clients in a short period of time.

Remittances: An important source of income for many families

One source of savings many institutions have been paying increasing attention to is the enormous volume of remittances that enter the Philippines every year. The Philippines exports the highest number of migrants in Asia and the second highest worldwide; approximately 44 percent of Filipino households are thought to have a family member abroad.[7] In 2004 these migrants sent over $8.5 billion in remittances through the banking system.[8] This was 10 times more than the transfers from overseas development assistance and 18 times more than net inflows of foreign direct investments (see figure 5).

Figure 5: Comparision between inflows of donations, net FDIs and remittances
(2004, Million $)



Source: BSP.

*BOP Net FDI flows refer to non-residents' placements less non-residents' withdrawals + reinvested earnings + net inter-company loans.

**Donations from governments and international organizations to the government and to NGOs.

[7] Although no exact number exists, the CFO estimated that as of December 2001, some 7.41 million Filipinos lived overseas, of which 3.05 million were OFWs, 2.74 million permanent residents, and the remaining 1.62 million were undocumented Filipinos residing abroad (Bagasao, 2004).

[8] A survey done by the PNSO in 2001 shows that 68 percent of Filipinos who send money home use banks, while 32 percent use informal delivery channels, "door to door" agencies or friends (Bagasao, 2004). The amount sent through informal channels is not known but is thought to be as high as 100 percent of formal flows.

When received through a bank, remittances facilitate the opening and maintaining of deposit accounts. Remittances can also attract more low-income savers if actively bundled with deposit products. However, remittances can be a disincentive for independent savings if they come on a regular basis like a salary. In this case, they are often withdrawn immediately to pay bills or debts.[9] Offering tailored accounts that help migrants and recipients put remittances to other intended uses, such as children's education, could help transform these flows into stocks of savings. Some insurance companies have been marketing pension plans to the migrant market, but uptake has apparently been limited. The plans were originally designed for upper-income clients and have not been modified for the needs of lower-income migrants.

Remittances are an extremely attractive business for commercial banks because of the transaction fees they generate and their role in customer acquisition. To market themselves to these potential clients, many commercial banks offer training courses on financial literacy to overseas Filipino workers (OFWs) before they emigrate. Some of this training is conducted in conjunction with the Overseas Workers' Welfare Association (OWWA) as part of their pre-departure orientation for migrants. OWWA also conducts reintegration trainings for returned OFWs, which include modules on financial literacy and savings. OWWA reports that whatever savings OFWs have accumulated, these are often quickly depleted upon their return, as families attempt to maintain the standard of living to which they have become accustomed. A term, contractual, or annuity-type deposit product that encourages returnees to delay withdrawal of their savings might serve client, institutional, and overall economic interests.

Micro Level: Retail Financial Providers

Main finding: Those financial institutions that cater most to low-income clients tend to demonstrate the weakest financial performance, while stronger institutions have few incentives to mobilize small-balance savings.

Different types of financial institutions address different client segments

Banks, cooperatives, and NGOs in the Philippines all offer deposit services to different market segments. The banking system has a tiered structure, with universal and commercial banks catering mostly to corporate and wealthy clients; thrift banks serving upper-middle income and SME clients; and rural banks serving lower-income clients.[10] These institutions are all regulated and supervised by the Philippine Central Bank (BSP) and deposits are partially protected by the Philippine Deposit Insurance Corporation (PDIC). Savings and credit cooperatives are widespread, especially in rural areas; although authorized to mobilize savings from their members, they suffer from weak supervision and have no deposit insurance. In addition, microfinance NGOs offer credit to poor clients. Although most NGOs require "compensating balances," they are not legally authorized to mobilize savings.

Banks

There are over 7,600 bank branches in the Philippines. The 42 **universal and commercial banks** have the highest minimum capitalization and widest branch network and can undertake the greatest variety of functions (see table 4). The 87 **thrift banks** have smaller minimum capital than commercial banks and more restricted functions. For example, unlike commercial banks, they are not allowed to do investment banking.[11]

Table 4: number of banks and bank offices in the Philippines (December 2004)

	Universal and Commercial banks	Thrift Banks	Rural and Cooperative Rural Banks	Total
Head offices	42	87	764	893
Branches	4,287	1,193	1,239	6,719
Total	4,329	1,280	2,003	7,612

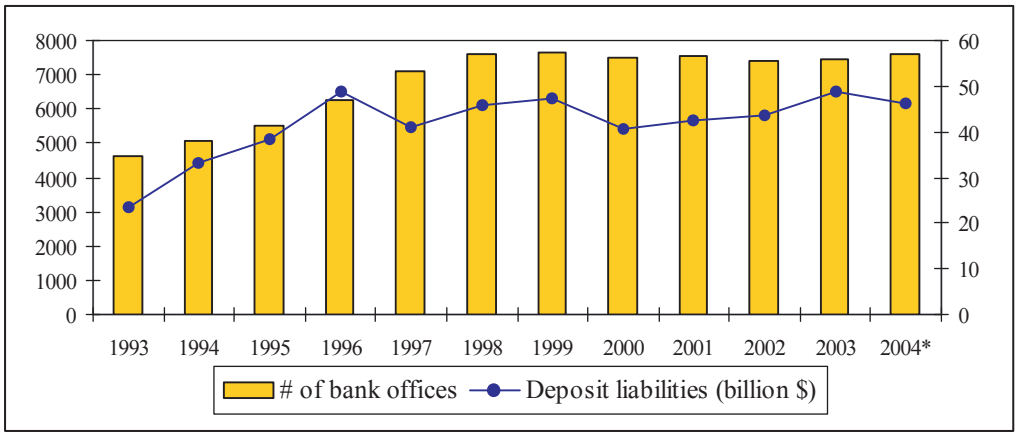
Source: BSP

[9] Bagasao (2004) finds that remittances are used by recipient families to pay back debts, including those incurred by migration (36 percent), for household expenses (32 percent), for household equipment and furniture (13 percent), for children's education (10 percent), and others.

[10] Development banks are a fourth category under Philippine regulations, but do not cater to the retail market.

[11] For an excellent summary of the various rules applying to different types of banks, see Llanto (2000b).

Figure 6: Number of banks and deposit liabilities



Source: BSP. *Deposits for 2004 as of September.

Rural banks and cooperative rural banks are the most numerous with the smallest minimum capitalization. They are mainly located outside Metro Manila and address the needs of lower-income clients. Rural banks cannot have foreign shareholders nor engage in foreign currency operations. They are owned by private investors and are often family-owned. Cooperative rural banks are owned by primary cooperatives.

Figure 6 shows that until the Asian financial crisis in 1997, the number of bank offices increased steadily. In 1999, the BSP issued a branching moratorium prohibiting the opening of new bank branches to encourage consolidation of the sector. Since 1999 the number of banks has diminished from 976 to 893, while the number of branches has remained almost the same.

This trend indicates mergers and acquisitions; specifically, the number of commercial, thrift, and rural banks diminished by 19, 26, and 5 percent respectively. While the number of branches remained the same for commercial and thrift banks, they increased by 15 percent for rural banks.

The recent increase in rural banks and branches is probably due to the partial lifting of the branching moratorium in 2001 for banks engaged in microfinance activities.[12] There are currently seven licensed microfinance banks, of which three are thrift banks (Opportunity Microfinance Bank, Micro-enterprise Bank, Dungganon Bank) and four are rural banks (CARD Bank, Banco ng Masa, Vision Bank, Xavier Tibod Bank).

By December 2003, banks had a total of $48.65 billion in deposits, of which 90.42 percent were held by universal and commercial banks, 7.26 percent by thrift banks, and 2.32 percent by rural banks (see figures 7 and 8). In terms of number of accounts, the rural banks play a more important role, holding almost 20 percent of the accounts in the banking system.

Figure 7:
Types of banks by volume of deposits

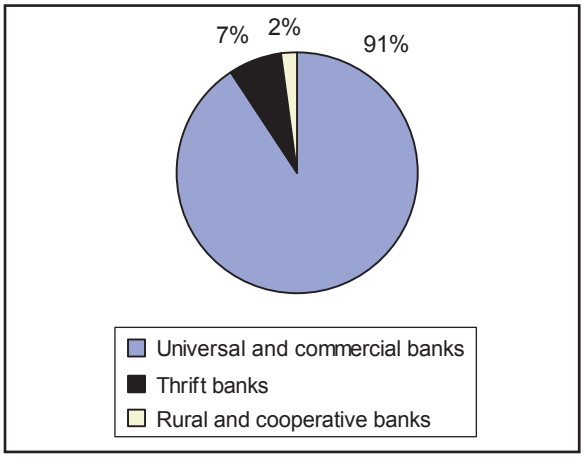
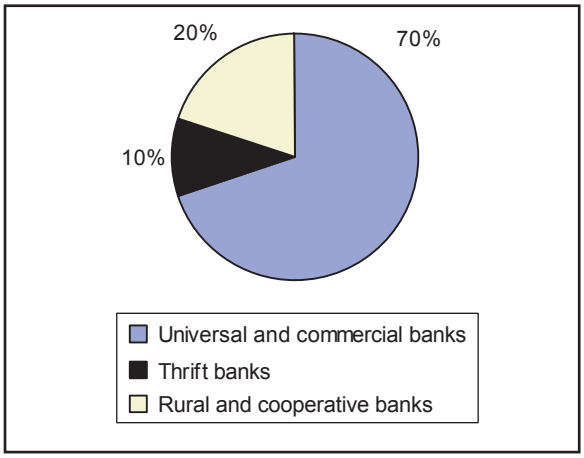


Figure 8:
Types of banks by percentage of accounts



Source: BSP

[12] BSP Circular 273.

Cooperatives

In the Philippines, financial services are offered by both dedicated and multi-purpose cooperatives that provide savings and credit services as a complement to other activities. These institutions are supervised by the Cooperative Development Authority (CDA). However, the CDA's supervisory capacity has until now been hampered by a lack of specialized finance expertise and a mixed mandate that includes both regulatory and promotional roles.

Because many cooperatives were formed to channel government subsidies and then went dormant, no exact figures on the total number active of cooperatives are available. Some say that around 4,000 dedicated cooperatives currently offer financial services in the Philippines.[13] According to CDA's annual report, by December 2003, some 31,191 dedicated and multipurpose cooperatives mobilized a total volume of savings and social capital of $140 million from 4.3 million members.[14]

NGOs

NGO MFIs (as well as multipurpose NGOs) provide micro-loans to low-income clients in the Philippines. The BSP does not authorize NGOs to mobilize savings from the public, but does not prohibit them from collecting compensating balances (as long as these are less than the value of the portfolio).[15] It is currently looking at ways to address the issue more appropriately.

Because NGOs have to register only with the Security and Exchange Commission (SEC) and are not subject to any regulation, the exact number of NGOs providing financial services is not known. A survey by the National Economic Development Association (NEDA) in 1996 counted a total of 600 NGOs involved in microfinance throughout the country.[16] Since 2000, the Microfinance Council of the Philippines Inc. (MCPI) has tracked the performance of its member MFIs. As of December 2003, 21 MFIs reported 578,493 borrowers, a portfolio of $42 million, and a total savings volume of $15.4 million.[17] Among a total of 562,340 savers, 463,463 were compulsory savers and 98,877 were voluntary savers.

While the incomplete data on cooperatives and NGOs do not permit definitive conclusions, available numbers indicate that they may serve poorer clients, and that cooperatives especially may be well placed to offer appropriate deposit services to very poor and rural populations. Table 5 compares different types of banks with cooperatives and NGOs. The figures clearly show that while cooperatives and cooperative and rural banks mobilize a relatively small proportion of total savings, they have an important weight in terms of clients served. Their low average account balances (of $354 and $219, respectively) also indicate they are serving poorer clients.

Affordability is one barrier to access for poor clients

Financial institutions in the Philippines offer three main types of deposit products: current or checking accounts, which pay little to no interest; savings accounts, which pay some interest; and time deposits, which offer the highest interest rates. A survey of 8 financial institutions in the Philippines found that, unlike in some countries, all these types of accounts were generally fee-free unless the account fell below the maintaining balance (see table 6).

Table 5: Deposits in the Philippines financial system (December 2003)

	Total volume		Number of accounts		Average account balance ($)
	billion $	percent	million	percent	
Universal and Commercial Banks	43.99	90.13%	17.92	58.56%	2,451
Thrift Banks	3.53	7.23%	2.69	8.76%	1,315
Rural and Cooperative Banks	1.13	2.32%	5.14	16.77%	219
Cooperatives*	0.14	0.29%	4.31	14.07%	354
Microfinance NGOs	0.02	0.03%	0.56	1.83%	27
Total	48.81	100%	30.65	100%	1,826

Source: BSP, MFC, CDA

*Savings volume includes members' social capital (on average $18 per share). The number of accounts corresponds to the number of members.

[13] Interview with CUES coordinator.

[14] CDA (2004).

[15] BSP Act 273. See also NCC (2005).

[16] Cited in Carpio (2004).

[17] Note that among these MFIs, one is a microfinance thrift bank (OMB).

Table 6: Characteristics of basic savings products in different types of banks and cooperatives

	UPLB-CDC (San Pablo, Laguna)	Palanan (Metro Manila)	Rural Bank of Nagcarla (San Pablo, Laguna	Rural Bank of Bay (San Pablo, Laguna	Planters Bank	Philippine Postal Savings Bank	Land Bank	Banco de Oro
Type of institution	Credit cooperative	Multi-purpose cooperative	Rural bank	Rural bank	Thrift bank	Thrift bank	Commercial bank	Universal bank
Entrance requirements	2 valid ID and birth certificate	Become a member with PhP 1,000	2 valid ID	1 valid ID	2 valid ID	2 valid ID	2 valid ID Tax ID number	2 valid ID
Minimum deposit to open	PhP 500	None	PhP 500	PhP 500	PhP 2,000	PhP 500	PhP 500	PhP 1,000
Minimum maintaining balance			PhP 100		PhP 2,000	PhP 500	PhP 500	PhP 1,000
Average daily balance to earn interest	PhP 500	PhP 100	PhP 500	PhP 500	PhP 3,000	PhP 500	PhP 500	
Fee on dormant account	None	None	None	PhP 10 per month after 2 years	PhP 50 per month if balance below PhP 2,000	PhP 50 per month if balance below PhP 500	PhP 100 per month if balance below PhP 500	PhP 50 per month if balance below PhP 1,000
Interest rate (annual)	3%	2%	2.4%	3%	1%	2.5%	1%	1%

Source: mystery shopping.

The survey also found that checking accounts were mainly targeted at high-value or commercial customers, with minimum opening balances of at least $100. Savings accounts generally had lower minimum opening balances, ranging from $10 to $40 in commercial banks, while rural banks and cooperatives had minimum opening balances that generally start at less than $2. However, cooperative members must also buy a share to access services, usually at a cost of around $20.

By way of comparison, in 2000 average daily household expenditure was $4.5 in rural areas and $10.1 in urban areas.[18] Poor clients would thus need to save up 2 to 10 times the cost of their daily necessities just to open an account in a commercial bank—a proposition that seems neither feasible nor attractive.

Another obstacle to poor people opening an account is the requirement of two valid identity cards.[19] Although both banks and cooperatives are required by law to insist on such identification, in practice, cooperatives and rural banks are thought to be less stringent.

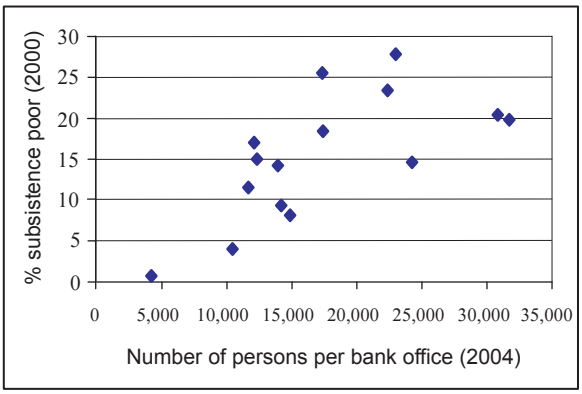
Proximity is key for low-income savers

Another important reason that banks tend to serve relatively wealthier clients is their location. The maps in Annex III show important differences in bank office density (population per bank branch) between rural and urban areas, and within Metro Manila. While in Manila, one bank office serves 4,190 persons, in Eastern Visayas and Zamboanga Peninsula there is only one office for over 30,000 people. Across regions, the number of persons per bank branch is strongly positively correlated (0.68) to the percentage of subsistence poor and negatively correlated to the population density (-0.48). As illustrated in figures 9 and 10, banks tend to open branches in richer and more densely populated areas.

[18] PNSO (2000).

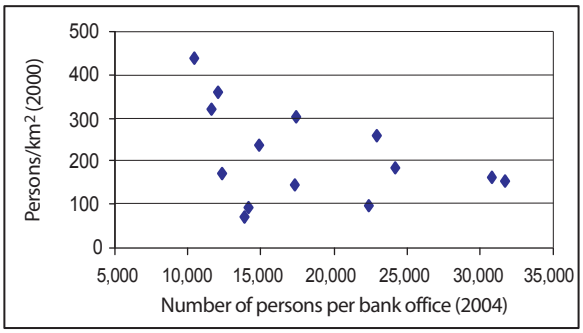
[19] See section on "macro level" for details on ID requirements.

Figure 9: Correlation between percent of subsistence poor and number of persons per bank office



Source: PNSO and BSP

Figure 10: Correlation between population density and persons/bank office



Source: PNSO and BSP

While this branching pattern makes economic sense for banks, it leaves poorer and more remote clients with less access to regulated deposit-taking institutions. Forty percent of the population lives in rural areas and can incur high transaction costs to go to a bank, in terms of transport expenses, time spent, and risk of being robbed. This is especially true in areas like the Autonomous Region of Muslim Mindanao, where the incidence of violence and unrest has meant that there are only a few commercial and rural banks.

Institutions that are more accessible to the poor tend to have weaker performance

Because of their outreach into poor and rural areas, rural banks and cooperatives are better placed to bring savings services to low-income clients. However, these institutions tend to be weak, potentially putting the deposits of the most vulnerable at risk.

According to available data (as of December 2004), the asset quality of rural banks, cooperatives, and NGOs is worrisome. Rural banks currently have an aggregated non-performing loan (NPL) ratio of 11.6 percent.[20] FOCCUS-rated[21] cooperatives have a portfolio at risk over 30 days of 8.76 percent. Before they entered the CUES project, this figure was 54.6 percent. As some of the most promising cooperatives were chosen for the CUES project, it can be inferred that the majority of cooperatives may suffer from serious financial problems. As of June 2004, the 16 institutions reporting to the MCPI had an average PAR 30 of 8.1 percent.[22] While this seems low compared to the above number on rural banks and cooperatives, MCPI membership includes only the bigger and more financially sound microfinance providers.

One indicator of the historical instability of rural banks is the 373 institutions currently in the process of being liquidated, leading to a reduction in the number of rural banks from over 1,000 in 1990 to 770 today. Although rural bank deposits are covered by deposit insurance up to PhP 250,000 ($4,563), recovery can take years (see box 2).

Box 2: Philippine Depository Insurance Corporation (PDIC)

The PDIC was created in 1993 to protect small depositors in the Philippine banking system. The insurance covers up to PhP 250,000 ($4,457) for each individual saver. For this coverage, the PDIC assesses a charge of 0.2 percent of total deposits on insured banks. The rural banks are the biggest concern for the PDIC given the number and geographical dispersion of small savers that are difficult and costly to locate and settle with in case of liquidation. Currently, almost 400 offices of rural banks are under liquidation, a process that can take up to 20 years until all claims have been settled.

The mixed performance record among the most accessible institutions is due in part to weaker management and governance and, in the case of cooperatives and NGOs, practically nonexistent regulation and supervision. In some cases, the very qualities that make these institutions accessible to

[20] NPLs are defined as loan accounts whose principal and/or interest is unpaid for 30 days or more after due date or after they have become past due in accordance with existing rules and regulations. The total outstanding balance is considered nonperforming. Restructured loans are generally considered as NPLs (for details, see circular no. 202 and 351 of the BSP). It is worth noting that with NPL ratios of 9.7 and 11.0 percent respectively, thrift and commercial banks are not much better off than rural banks.

[21] FOCCUS corresponds roughly to the PEARLS rating system of WOCCU and has been introduced by the CUES project.

[22] Of these, 13 were MFIs, 2 were rural banks, and one was a thrift bank.

the poor—remote locations and low cost structures—make it difficult for them to attract the best trained and experienced staff. The Central Bank requires certain minimum training for new directors and managers of rural banks; however, because cooperatives and NGOs fall outside of the BSP's purview, these requirements do not apply to them.

The lack of incentives for savings dampens innovation among rural banks

Strong institutions lack incentives to develop products for the low-income market, which may help explain the dearth of quality deposit options available. All types of banks in the Philippines are currently overliquid. The ratios in table 7 indicate a widespread conservatism in lending among banks. Banks can easily meet their lending requirements by mobilizing deposits from corporate and upper- and middle-income clients—i.e., the "low-hanging fruit." They do not need to extend services among low-income clients to survive or grow.

Table 7: Gross loans over deposits (Dec. 2004)

Commercial banks	77.5%
Thrift banks	77.1%
Rural banks	90.3%
Cooperatives (38 CUES coops)	122.0%
NGO MFIs (16 MCPI MFIs)	227.2%

Source: BSP, CUES, MCPI

Those few banks that might need liquidity can easily obtain a credit line from one of several wholesale institutions (see table 8), which actively offer funds to the strongest rural banks and cooperatives. In comparison, the resources and effort needed to mobilize small savings seem prohibitive. The direct financial cost of small savings, 1 to 3 percent, is lower than the prevailing rates on wholesale credit lines, 5.9 to 12 percent. However, the reorientation of an institution's systems and staff necessary to successfully mobilize large volumes of small savings is a much more daunting task than simply availing of one of the many sources of wholesale credit.

Over liquidity combined with easy-to-access funding alternatives add up to an almost complete lack of economic incentives for strong financial institutions to focus on the low-income market for deposits. Without incentives, institutions are not motivated to innovate, and most offer a fairly standard set of deposit accounts—although some banks, like Banco de Oro, have overcome these disincentives (see Box 3).

Box 3: Incentivizing small-balance savings collection

Banco de Oro offers an example of the factors that can motivate a strong financial institution to pursue small-balance savers. Banco de Oro is owned by the Philippines' largest retailer, ShoeMart, which sees one million customers walk into its shopping centers every day. Compared to opening stand-alone branches, installing Banco de Oro outlets in ShoeMart malls gives the bank a less expensive way to put itself squarely in the path of an enormous number of potential customers. The resulting cost reduction makes servicing small-balance accounts more viable for the bank.

ShoeMart's knowledge of customer behavior can also help Banco de Oro design appropriate products, such as the Banco de Oro Cash Card, an "account-less" prepaid debit card. Cash Cards can be used at ATMs and reloaded at ShoeMart counters, turning every cash register into a Banco de Oro service point and further reducing administrative costs. Banco de Oro earns revenue on these accounts through transaction fees paid by merchants for each Cash Card purchase. The possibility of migrating these customers to higher-value products, such as money transfers, has also spurred the bank's interest in pursuing the market of small-balance savers.

Meso Level: Service Providers, Financial Infrastructure, and Second-Tier Funds

Main finding: Overliquidity and abundant second-tier funds dampen institutional incentives for small savings mobilization, which is exacerbated by incomplete financial infrastructure.

Associations and projects promote better performance

In the Philippines, the meso level of the financial system is populated by training centers, auditing companies, and various associations and federations that promote best practice among members and lobby for their interests. Each type of bank has its association: the Bankers Association of the Philippines for commercial banks, the Chamber of Thrift Banks, and the Rural Bankers Association. In the cooperative sector, two federations—NATCCO and PFCCO—represent the interests of most cooperatives, provide capacity building and technical assistance, and promote standardization of financial reporting and monitoring among members. Some cooperatives are members of both federations, and both federations are members of the Asian Confederation of Credit Unions. They have recognized the need to integrate their efforts, in particular to standardize regulation and supervision of cooperative members that engage in savings and credit.

Bilateral development agencies (most notably USAID, CIDA, and GTZ) have identified the potential of cooperatives and rural banks to provide savings services to low- and middle-income households living outside the main urban centers. Projects like MABS and CUES offer capacity building and training to rural banks and cooperatives, respectively. These programs have proven that participating institutions progress rapidly in terms of client growth and financial performance. They emphasize savings mobilization to become less dependent on development assistance and second-tier funds. They have introduced financial reporting formats and rating systems to increase transparency and create competition for results among participants. Example of these are CAMELS (with S for Sensitivity to market risk), used for banks; EAGLE, used for rural banks participating in MABS; ACCESS, FOCCUS, FIRM, and COOP-PESOS for cooperatives; and PESO for all types of institutions. The proliferation of rating systems causes some confusion, however, among financial institutions and potential clients.

The main voice of NGO MFI interests is the Microfinance Council of the Philippines (MCPI), which promotes best practices among its members (currently 23). In coordination with the BSP, it is the focal point for increasing financial transparency among NGO MFIs. It currently monitors members' performance using the MIX Market reporting format. The MCPI will transition to the PESO system in early 2006 and also recognizes the need to standardize its charts of accounts. The Mix Market is now also working with MABS and RBAP to increase financial transparency among rural banks.

"Easy money" from wholesale financial institutions floods the market

Until the late 1990s, different government line agencies managed directed credit programs (DCPs) providing subsidized loans to retail financial institutions or directly to end clients. In 1997, the National Credit Council (NCC) published the National Strategy for Microfinance (see box 5), which stated the government's policy in favor of market-based delivery of financial services to the poor. As a result of this policy and accompanying laws, these market-distorting credit programs have been slowly winding down.[23] The continuing effort to phase out DCPs is to be congratulated and encouraged, especially given the periodic threat of their re-emergence as convenient political tools.

The main source of wholesale financing to retail institutions serving poor clients is the donor-funded, so-called "program loans," which are routed through government-owned institutions (see table 8). The most important conduits for program loans are currently:

- The Land Bank of the Philippines (LBP) and the Development Bank of the Philippines (DBP), government-owned banks that provide refinancing to rural banks and cooperatives.
- The People's Credit and Finance Corporation (PCFC), a registered finance company under the Securities and Exchange Commission.

In 2002, the BSP opened a rediscounting facility for microfinance-oriented banks, granting rediscounting to 15 banks, involving 33,000 micro borrowers.

These wholesale funds come mainly from the World Bank, Asian Development Bank, JBIC, and KfW. Together, these agencies have channelled approximately $356 million through government-owned financial institutions, an amount equivalent to 32 percent of the $1.13 billion deposits mobilized by rural banks.

These credit lines represent an advance over donor practices in many countries in that most are lent at market or near-market interest rates. However, it is not clear whether these credit lines meet their stated purpose of filling a gap in medium- and long-term financing for banks. Nor is it clear whether program loans actually increase the amount of medium- and long-term lending by banks. In the face of widespread conservatism in bank lending, the availability of finance does not necessarily change bankers' risk/reward perception of a longer-term project. The over liquidity in the Philippine financial system calls into further question the need for such large amounts of external refinancing.

Recipients of these funds must meet stringent minimum performance thresholds. Interviewees report that the conduit institutions find it difficult to identify suitable partners, and so must market aggressively to the few institutions strong enough to be eligible. From a savings mobilization perspective, then, precisely those institutions that would make the safest home for poor people's savings have the least incentive to mobilize them.

[23] Conroy (2003).

Table 8: Most important government wholesale credit funds

Wholesaler	Type and number of retail institutions	Outstanding loan ($ million)	Interest rate (annual)	Final clients
LBP	400 rural banks 1000 cooperatives	355.4 (Dec. 2004)	7.5%	SMEs, small farmers, fishers, veterans and pensioners.
PCFC	199 (107 rural and cooperative rural banks, 54 coops, 34 NGOs, 3 thrift banks, 1 lending investor)	51.7 (May 2005)	12%	1.2 million persons, for livelihood, 95% women
DBP	Cooperatives, banks, local government units, NGOs	0.65 (Dec. 2003)	7.38%	SMEs
BSP microfinance rediscounting window	15 microfinance oriented thrift and rural banks	0.31 (March 2005)	5.9%	33,000 micro borrowers

Sources: Interviews and web site information from PCFC, LBP, DBP, BSP. Report of JBIC (2004).

Incomplete financial infrastructure for rural banks and financial cooperatives

Rural banks and cooperatives are not directly connected to the national payment system. Weaknesses are also reflected in the quality of the services offered. From a savings mobilization perspective, lack of access to the payments system impedes financial institutions' ability to serve low-income clients who prefer to access their money at multiple locations, or receive remittances or other payments directly. Most rural banks and all cooperatives and NGOs cannot link directly into national payments switches, but instead must transact through their accounts with other banks. At this time, one rural bank has recently gained direct access to the Philippine Clearing House and opened its own automatic teller machines (ATMs), but the vast majority of accessible institutions cannot offer ATM services. Rural banks' and cooperatives' inability to hold foreign currency deposits also disadvantages them in terms of receiving remittances, since many migrants prefer to keep their earnings in hard currency.

Moreover, most rural banks are limited to one district or region, restricting clients' ability to move money around the country. Until rural banks can connect directly to the payment system, these entities are seeking intermediate solutions like partnering with commercial banks to open ATMs.

Lack of access to the payments system also means that liquidity management is more difficult for rural banks and cooperatives. The cooperative federation NATCCO has recently introduced a Central Liquidity Fund that gives members access to refinancing facilities; however, few cooperatives are linked to it yet. Rural banks have started to lend and borrow among each other when they have excess or insufficient liquidity. This practice faces a regulatory hurdle. Liquidity placements in other banks are treated as loans and subject to the single borrower limit (25 percent of unimpaired capital). This requirement increases the complexity and cost of depositing funds in other banking institutions, a potentially simple and convenient liquidity management mechanism.

Information and communication technology is revolutionizing access to banking services

By the end of 2004, 33 universal and commercial banks and 11 thrift banks had ATMs. They had 5,469 ATMs, of which 5,100 were operated by commercial banks and 369 by thrift banks. In the last 6 months of 2004, the number of ATMs increased by 657 units. In 2005 one rural bank has installed ATMs. This evolution will soon be followed by other rural banks and should increase the areas' accessibility to deposit services while simultaneously broadening the access of rural bank clients to the national payment system.

Another promising development for increasing banking outreach is mobile phone banking applications offered by Philippine telecom companies (see box 4). Thirty-five percent of Filipinos own a mobile phone, and Filipinos are the biggest users of text messaging in the world, sending more than 200 million Short Message Service (SMS) messages a day. The mature SMS market has trained Filipinos to use the phone as a data instrument, facilitating their adoption of mobile banking products.[24] As a solution for low-value payments, the potential of mobile banking applications to increase savings mobilization is enormous.

[24] Simpson & Liew (2005).

Box 4: Mobile Banking in the Philippines

In 2003, SMART Communications launched mobile commerce applications, including mobile banking and "Smart Money." This technology allows users to pay for purchases by transferring money from a bank account or reloading a prepaid card electronically through the user's mobile phone. The SMART service also allows users to make and receive domestic payments and to receive international remittances into their mobile phone account. The recipient can then withdraw cash from the phone account at either an ATM or one of 50,000 SMART encashment centers, including retail stores, gasoline stations, pawnshops, and McDonalds. SMART is currently processing approximately 2 million mobile banking transactions per day.

In 2004, Globe Telecom launched G-cash, another mobile banking service that differs from Smart Money mainly in that Globe does not issue a debit card to accompany the mobile phone account. In five months, G-Cash acquired 320,000 users, generating between 4,000 and 5,000 transactions a day. However, G-Cash managers are targeting a potential volume of 1 million daily transactions and have been aggressive in marketing the service to financial institutions. Through a partnership with the Rural Bankers' Association, with the support of MABS, several rural banks are currently piloting G-cash for the repayment of loans and the receipt of remittances.

By eliminating the need to build costly bank infrastructure, they can bring down the cost of mobilizing small savings, one of the main obstacles for financial institutions. In the near future, retail bank-to-bank transactions might even be switched via the phone companies. If this happens, mobile banking operations may free rural banks and cooperatives from the need to connect to the payment system at all.

Macro Level: Legal and Regulatory Framework for Micro Savings Mobilization

Main finding: Supervision of deposit-taking institutions is uneven: while cooperatives and NGOs are effectively unsupervised, overly restrictive rules on banks limit their ability to reach poor clients.

Philippine regulatory framework encourages financial service delivery to the poor by regulated, commercial institutions…

The Philippine government explicitly promotes a market-based microfinance policy aimed at increasing the outreach of financial institutions to the majority of the population (see box 5). It recognizes that different types of private banking institutions are required to address diverse client needs. At the same time, the policy is mostly oriented toward microcredit, with very little discussion of the implications for deposit services. The Philippines' microfinance strategy defines the appropriate role of government as establishing an enabling environment rather than providing services directly. The phase-out of the DCPs was a particularly important demonstration of this approach and should be applauded. However, continued vigilance is required to prevent the resurrection of these programs and the imposition of other unfavorable policies, such as interest caps, that some claim is a constant threat.[25]

Through graduated minimum capital and other requirements, the Philippines' tiered banking structure has made it possible for banking institutions to serve low-income clients in remote areas. The rural banks, in particular, can operate in areas where potential profits may not meet the hurdle rates imposed by mainstream commercial banks.

Box 5: The Philippines National Strategy for Microfinance

The National Credit Council (NCC), at the department of finance, was established in 1994 by the government with the objective of rationalizing government lending programs and developing a national microfinance policy capable of addressing issues of poverty. In 1997, the NCC published the National Strategy for Microfinance, which set the path for the development of a private-sector-led and market-oriented microfinance sector, accompanied by a conducive legal and regulatory environment.

This strategy sets the policy framework of microfinance in the Philippines, based on the following principles:

- The private sector should provide microfinance services.
- The policy environment will facilitate the participation of the private sector.
- Market-oriented interest rates on loans and deposits.
- Non-participation of government line agencies in the implementation of credit/guarantee programs.

The policy, among others, strengthens the importance of:

- An appropriate supervisory and regulatory framework for MFIs.
- The establishment of standards of performance.
- The promotion of broad-based savings mobilization, linkage banking technology, and other microfinance technology.
- Provision of information and training to MFIs on best practices in microfinance.

Sources: NCC and Conroy (2003)

[25] Llanto (2004a).

…But supervision is uneven: too little for non-bank institutions, and potentially too much for banks

Cooperative and deposit-taking NGOs lack effective prudential supervision. At the same time, banks are constrained by a supervisory framework that may have erred on the side of too much caution in the aftermath of the Asian financial crisis. This tendency toward rules-based, rather than risk-based, supervision limits banks' ability to reach out to underserved markets and seems to encourage regulatory arbitrage and evasion.

The most frequently mentioned example of this type of limitation is the moratorium on branching. Issued in 1999, it indefinitely suspended the opening of new branches and new banks except in municipalities without banks. In 2001, the BSP lifted this moratorium for rural and thrift banks engaging in microfinance activities (defined as a maximum loan of 150,000 PhP or $2,740).[26] The intent of this exception is to encourage banking growth in underserved areas.

But the exemptions themselves do nothing to change the risk/reward ratio intrinsic to opening a branch in a poor or remote locality. In the meantime, the moratorium does protect the rural bank monopolies that exist in many municipalities—again, dampening incentives for banks to improve service to low-income customers. Single-location rural banks also complain that the moratorium limits diversification of their operations, inhibiting risk management.

The implementation of the moratorium and its exceptions has also been problematic. Ambiguous guidelines on branching for microfinance-oriented thrift and rural banks and long waiting times to receive licenses slow down the creation of new branches and the entry of new players in underserved markets. To circumvent the branching moratorium, banks have apparently been setting up non-bank microfinance subsidiaries. While these companies can offer credit, they cannot legally take deposits.

Other BSP regulations also hinder small savings mobilization by banks. For example, off-site deposit collection was prohibited by the BSP in 1999.[27] This rule reduces the ability of rural banks to mobilize savings, especially in less densely populated areas. Moreover, many customers have come to expect this type of service because roving moneylenders have traditionally offered doorstep repayment collection. Customer demands have motivated some rural banks to collect deposits through cash boxes or ambulatory deposit collectors, even if it means operating at the margin of legality. The BSP's concern is perhaps understandable from a security and fraud point of view. However, more openness to innovative practices would help regulated institutions capture more small deposits by reducing transaction costs to clients and attracting savings from the informal to the formal system.

Finally, Know Your Customer (KYC) rules implemented to prevent money laundering also block poor customers who wish to open deposit accounts. As in many other countries, KYC rules in the Philippines require two forms of government-issued identification to open a bank account. The Philippines have no national ID system and poor people working in the informal sector often have only one ID, issued by the local authority (Village Clearance Card)—if that. In addition, KYC rules require proof of residence. While higher-income clients may be able to furnish utility bills and other allowable forms of proof, these are often impractical or impossible for the poor.

Strategies to Improve Small Deposit Mobilization in the Philippines

> Assets accumulated by people who are already economically vulnerable are too valuable to entrust to institutions that risk losing them.

Based on background research and many interviews in the Philippines, including roundtables with representatives of the banking system and donor agencies, the authors suggest some strategies for improving the access of poor clients to savings services. These suggestions require further reflection and elaboration, and CGAP would be pleased to work with stakeholders to help implement them.

1. **Collect more data on clients' savings patterns and preferences**. Studies analyzing the savings behavior of low-income households and their potential demand for deposit services were extremely difficult to find. Up-to-date and accurate demand-side data will be crucial for both financial institutions and policy makers that wish to increase deposit options for poor Filipinos. The ACPC's Small Farmer Indebtedness Survey could represent a prime opportunity for quickly increasing the amount of data available on small savings. ACPC staff have already expressed openness to the possibility of adding a few questions to this year's survey, which is currently being finalized.

[26] BSP circular 273.

[27] BSP circular 118.

In terms of longer-term research, one project of potential interest is FinMark Trust's FinScope survey. Currently being replicated in several countries, FinScope forms a coalition of financial institutions to back a comprehensive household survey on access to and usage of multiple financial services.[28] In addition to financial institutions, universities and research firms might be tapped as partners in future research efforts such as this. Bodies, such as the NAPC, might be well-positioned to play a coordinating or commissioning role.

In part, data are lacking because small savings collection is not seen as a business opportunity by commercial banks. As in microcredit, the challenge might be to make a business case for small savings collection.

2. **Expand financial literacy efforts for residents, leveraging experiences with Overseas Filipino Workers**. Many Filipinos agree there is a lack of a "savings culture" in the country. At the same time, extensive investments have been made to provide financial education to OFWs when they leave and return. These efforts should be expanded and replicated more widely to include people unconnected to the migration process. This would not necessarily require government expenditure, as commercial banks would likely be willing to deliver the financial education as a customer acquisition tool. However, bank representatives have expressed a desire to coordinate more closely with government experts to develop an accepted "storyline" or curriculum for this type of training.

3. **Institutionalize and expand successful technical assistance programs on a sustainable basis**. Financial analysis of rural banks and cooperatives has revealed weaknesses in their performance. Certain donor-funded capacity-building projects have proven successful in improving that performance. These efforts should be institutionalized, i.e., integrated into existing local structures and associations to ensure their sustainability beyond the end of the respective projects. Permanent sources of technical assistance are crucial given the sheer numbers of rural banks and cooperatives in operation and the relatively small fraction that have benefited directly from donor projects.

4. **Build on existing monitoring systems and rationalize ratings to enhance transparency and client confidence**. Various projects and associations have introduced their own financial reporting and rating systems (i.e., CAMEL, PESO, FOCCUS, FIRM, ACCESS, EAGLE) that have fostered competition among institutions and have increased transparency and growth. However, the proliferation of rating systems reduces the power of each one. Rationalizing these systems into one, like PESO, would increase incentives for performance by enabling comparison across more institutions. It would also increase the value of the rating's "brand" as a mechanism to inspire the confidence of consumers, for whom multiple rating systems are likely to be very confusing.

5. **Evaluate alternatives for electronic banking and payment services for rural banks and cooperatives.** The ability to move money from place to place is essential for mobilizing small deposits, both for capturing remittances and because clients are less likely to deposit in one location if their money is inaccessible to them elsewhere. Up until now, rural banks and cooperatives have provided payment services only through other institutions, making this service impractical or impossible. However, with the advent of mobile phone banking, this situation is changing. Together with rural banks and cooperatives, the BSP should evaluate the pros and cons of emerging e-payment solutions (e.g., e-transfers, ATMs, mobile phones) for leapfrogging traditional systems and offering payment services to more poor clients.

6. **Strengthen financial cooperative supervision**. Although the exact number of depositors they serve is not known, available data indicate that cooperatives may serve a poorer clientele than banks, even rural banks. In this light, improving cooperative supervision is crucial, and current efforts to do so should be supported. The current move to eliminate the CDA's promotional role in favor of a regulatory mandate is a necessary first step. However, it may not be sufficient given the number of cooperatives in existence and the current weakness of the CDA's supervisory capacity. Various models of delegated supervision should be explored. Best practice also advises establishing a separate set of regulations and supervisors for savings and credit cooperatives, different from those for multipurpose cooperatives.

[28] Detailed information on FinScope is available at www.finscope.co.za.

7. **Re-evaluate the need for program loan funds, and continue phasing out directed credit programs**. The common rationale for program loans is that they fill a gap in medium- and long-term wholesale finance. However, more research on the stability and tenor of deposits needs to be done before this reasoning can be accepted, especially in light of the disincentive these loans produce for institutions to mobilize savings. Perversely, this disincentive acts most powerfully with regard to small savings—which are perceived to be higher-cost—and on strong institutions, which are best-placed to mobilize them. Renewals of wholesale funds, apexes, and/or rediscount lines should consider the crowding-out effect they seem to have on mobilization of deposits, especially from small savers.

8. **Shift the supervisory framework for banks from operational restrictions toward risk-based supervision**. Current efforts to limit systemic risk and encourage consolidation have translated into operational rules that may inhibit regulated institutions from serving poor markets. A supervisory framework that emphasizes compliance with prudential ratios or measures based on an assessment of real or probable risk (instead of limiting banks' operational choices) could keep risk at an acceptable level while enabling banks to pursue neglected market niches. According to the latest information, the BSP is currently thinking of adopting risk-based supervision and is in the process of instituting the necessary reforms. The branching policies are also under discussion.

9. **Update the national microfinance policy**. Although the 1997 strategy is still valid (especially for microcredit), the NCC should draft an updated version to reconfirm the government's commitment to a market-based approach and offer better guidance on other financial services, including savings. A consultative re-drafting process involving representatives from government, donors, financial institutions, and client groups, could trigger increased dialogue and focus on non-credit financial services for the poor. Tapping the National Savings Council to spearhead efforts to draft the language on deposit services might both help to reinvigorate the Council and provide a home for policy coordination and promotion of small-balance savings.

Annex 1 Summary Matrix of Opportunities, Obstacles, and Suggested Actions

Level	Opportunities/Strengths	Obstacles/Weaknesses	Suggested actions
Clients	- Evidence of savings capacity among low-income Filipinos - Institutions that have focused on delivering quality savings services have increased deposits	- Skepticism about savings ability perpetuated by lack of data - Demand may be limited by intimidation or unfamiliarity with financial institutions	→ Collect more data on savings preferences of low-income Filipinos → Expand financial literacy efforts for residents
Micro	- Majority of depositors served by a variety of regulated institutions	- Institutions closest to the poor are weakest in terms of performance, governance, management - Institutions caught in a liquidity trap - Perceive cost of small savings to be high - Foregoing 2 factors dampen incentives for institutions to mobilize small savings	→ Institutionalize and expand successful technical assistance programs on a sustainable basis
Meso	- Numerous associations and TA projects bolster institutional capacity - Payment system may be bypassed by mobile banking systems	- Easy money flooding the market, partially from remaining DCPs but mainly from program lending operations - Institutions serving the poor lack liquidity management mechanisms, connection to payment system - Multiple rating systems confusing for institutions and clients	→ Continue phasing out DCPs; determine whether program loans fulfill purpose and are necessary → Evaluate alternative e-payments options (ATMs, cell phones, etc.) → Encourage consolidation of federations; build on and rationalize rating systems to enhance performance and client confidence
Macro	- Government's policy stance encourages commercial microfinance - Tiered banking structure makes it more viable for regulated institutions to serve poor markets	- Institutions closest to clients operate in regulatory void - Operational restrictions may limit bank outreach and encourage regulatory arbitrage, evasion - AML rules are barrier to low-income clients	→ Strengthen supervision at CDA and/or delegated models → Shift regulatory framework from operational controls toward risk-based supervision → Update national microfinance policy to reconfirm commitment to market-based approach and offer guidance on other financial services, including savings

Annex 2

Sources of Information on Savings in the Philippines

Statistics and Web Sites

Central Bank of the Philippines: www.bsp.gov.ph

Philippine Depository Insurance Corporation: www.pdic.gov.ph

Microfinance Council of the Philippines: www.microfinancecouncil.org

National Credit Council: www.dof.gov.ph/htm/microfinance_reg.asp

Philippines Homeless People's Federation: www.achr.net/philippines1.htm

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Annex 3

Map 1: Banking office density by province

Map 2: Banking office density in the National Capital Region

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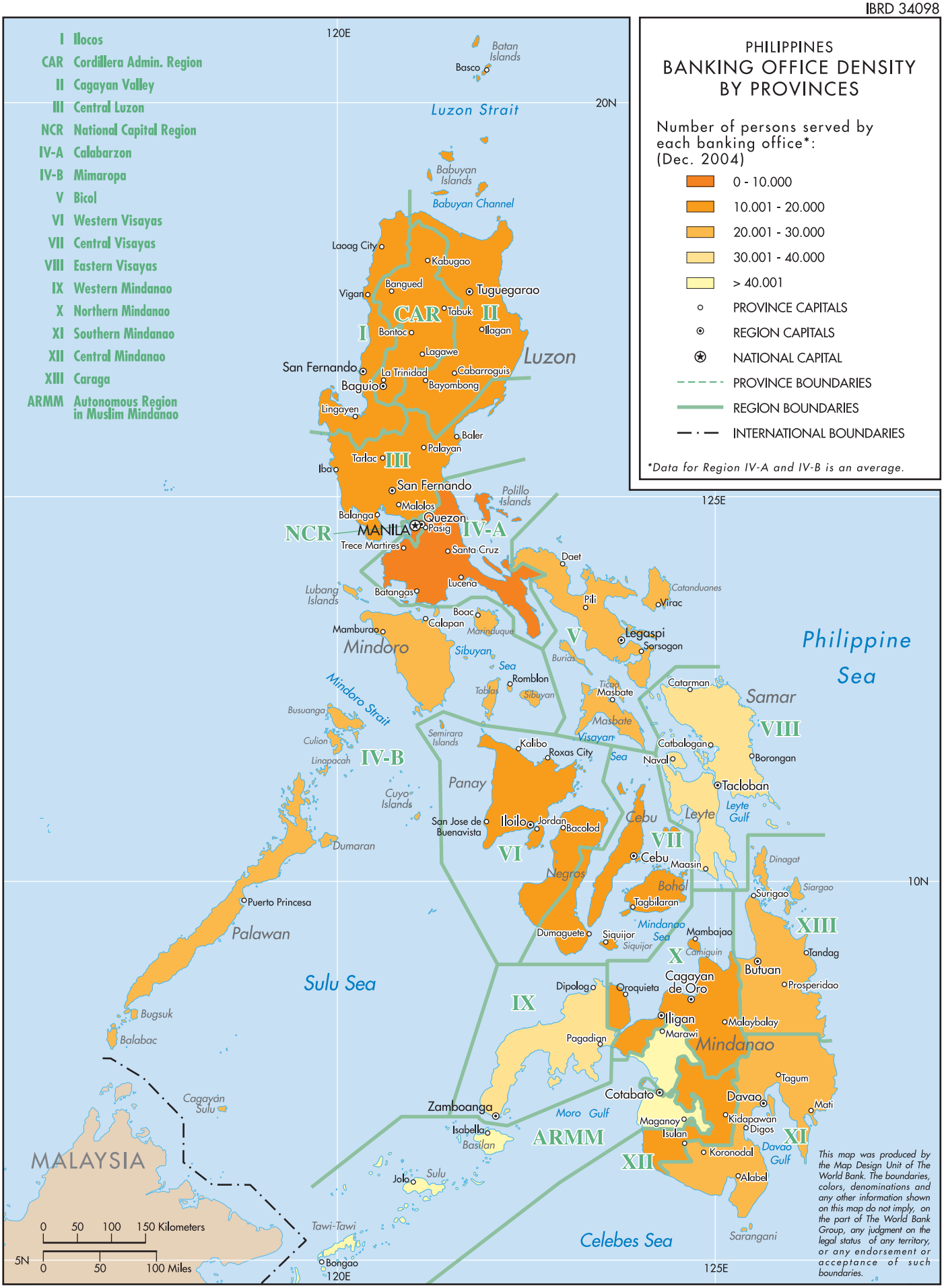

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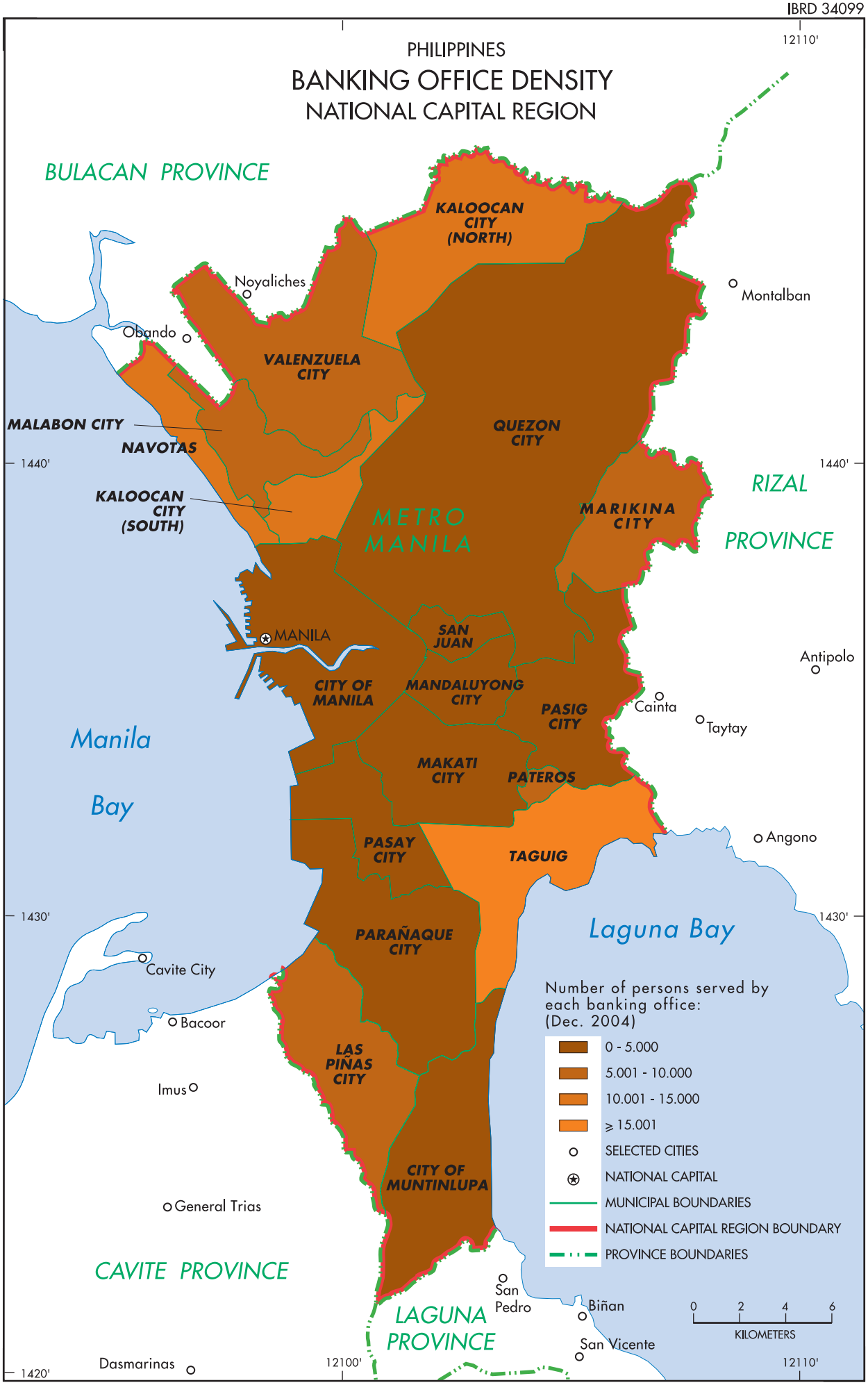
PHILIPPINES

BANKING OFFICE DENSITY

NATIONAL CAPITAL REGION



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