



Expert Meeting on  
**THE IMPACT OF ACCESS TO FINANCIAL SERVICES,  
INCLUDING BY HIGHLIGHTING THE IMPACT ON REMITTANCES ON  
DEVELOPMENT: ECONOMIC EMPOWERMENT OF WOMEN AND YOUTH**  
*12-14 November 2014*

**POLICIES AND REGULATION FOR FINANCIAL INCLUSION:  
PHILIPPINE EXPERIENCE**

## **Policies and Regulation for Financial Inclusion: Philippine Experience**

### ***Rationale – Empirical Evidence and Global Trends***

Access to financial services is important for every household and business. Recent empirical evidence indicated that access to basic financial services such as savings, payments and credit make a substantial positive difference in people's lives (Dupas and Robinson, 2009). In addition, a financial system which is able to mobilize broad-based savings and invest in the growth of the productive sector drives economic growth (Levine, Loayza and Beck, 2000). Aside from the strong indications of the relationship of deep financial systems to growth, a deeper and more diversified financial system also contributes to financial stability (Hannig and Jansen 2010).

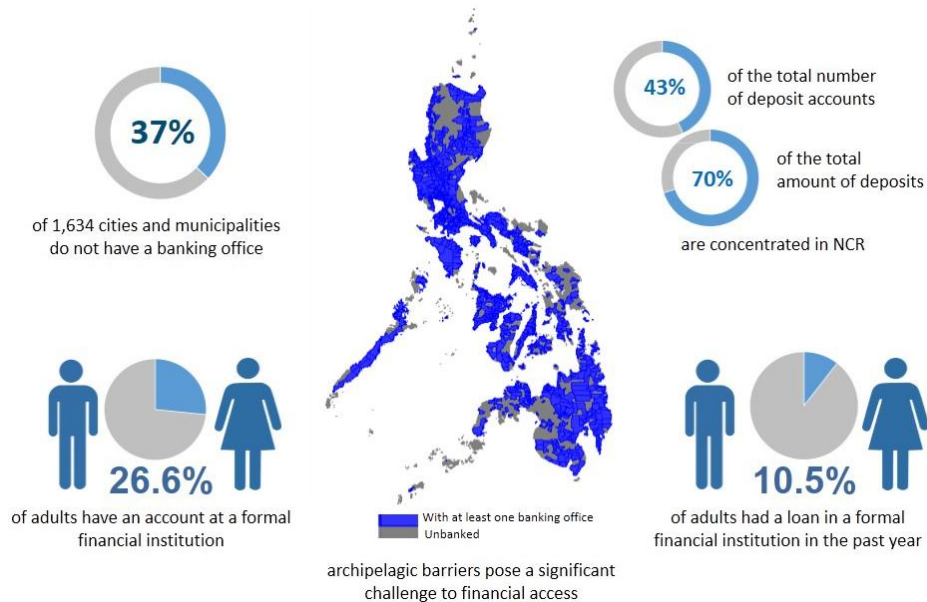
Interest in building an inclusive financial system has therefore become an important policy objective and one that has been receiving increased national, regional and international attention. Bodies (e.g., G20) have recognized the reinforcing policy objectives of financial stability, financial inclusion and consumer protection. In 2010, they created the G20 Global Partnership for Financial Inclusion (GPFI), its implementing arm for financial inclusion related initiatives. Standard Setting Bodies (SSBs)<sup>1</sup> are also recognizing that financial inclusion is something that can be complementary to their respective mandates. This recognition is also evident in the growing number of countries adopting some aspect of a financial inclusion agenda under the purview of the main financial regulator.

### ***Philippine Perspective***

The Philippine banking system remains strong and resilient, and the network of banking offices and automated teller machines (ATMs) has been expanding through the years. Yet, the challenge of increasing access to financial services remains a daunting one. At present, nearly 600 of the country's 1,634 cities and municipalities remain unbanked. In addition, the distribution of banking services is skewed towards highly urbanized and populous areas leaving much of the low income areas significantly underserved. For example, 43% of the total number of deposit accounts and 71% of the total amount of bank deposits are concentrated in the National Capital Region (i.e., Metro Manila). Translating access into usage is another challenge because only 26.6% of Filipino adults have a formal account while only 10.5% of adults obtained a loan from a formal financial institution in the past 12 months (World Bank Findex, 2012). Indeed, many Filipinos, especially the poor, are still left wanting for much needed financial services.

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<sup>1</sup> SSBs include Basel Committee on Banking Supervision (BCBS), Financial Action Task Force (FATF), International Association of Deposit Insurers (IADI), International Association of Insurance Supervisors (IAIS), Committee on Payments and Market Infrastructures (CPMI) and International Organization of Securities Commissions (IOSCO).



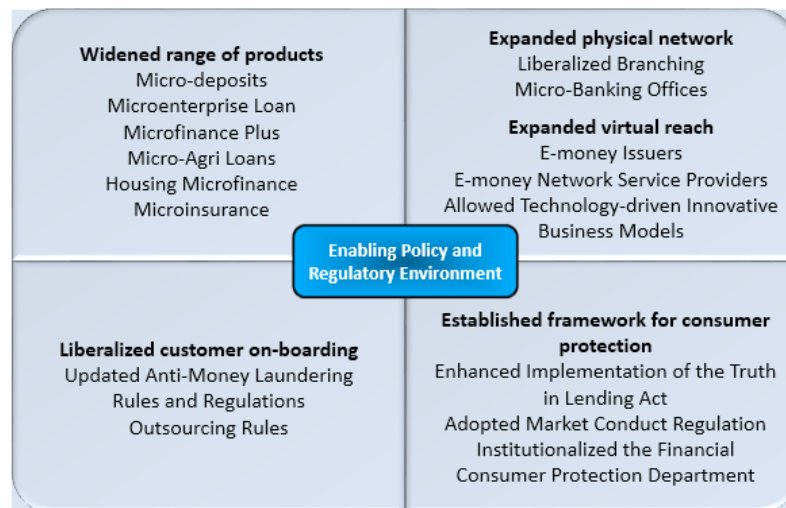
### ***BSP Initiatives***

The BSP has therefore taken deliberate measures to promote financial inclusion in the Philippines. As the central monetary authority and banking system regulator, the BSP recognizes that financial inclusion is a worthy policy objective that can be pursued alongside the promotion of financial system stability and integrity. As early as 2000, the BSP has played a key role in the development of sustainable microfinance in the country by setting in place an enabling policy and regulatory framework for microfinance. The success of microfinance efforts has emboldened the BSP to move toward a more ambitious goal of increasing access to financial services for all. In 2007, the BSP was one of the first central banks in the world to establish an office dedicated to financial inclusion when it created the Inclusive Finance Advocacy Staff (IFAS). The BSP has also established a working definition<sup>2</sup> of financial inclusion and mapped a strategy based on four key areas:

- Financial education and consumer protection: ensuring that consumers are protected thru adequate market conduct regulations, and increasing their financial literacy thru targeted financial education programs
- Advocacy: building linkages and being involved in projects and activities in partnership with public and private sector stakeholders to increase awareness and generate support for financial inclusion

<sup>2</sup> The BSP defines financial inclusion as “a state wherein there is effective access to a wide range of financial services for all”. “Effective access” does not only mean that there are financial products and services that are available. Aside from physical access to financial services, these services must be appropriately designed, of good quality and relevant to lead to actual usage that can benefit the person accessing the said service. “Wide range of financial services” refers to a full suite of basic services for different market segments, particularly those that are traditionally unserved/ underserved.

- Data measurement and management: developing a comprehensive financial inclusion data framework to monitor progress, identify gaps and craft evidence-based financial inclusion policies
- Regulation and supervision: ensuring that the policies and supervisory framework are conducive to financial inclusion



The general approach is to ensure that an enabling regulatory environment is in place that will allow innovations and market-based solutions to thrive. The BSP recognizes that the access to finance challenge cannot be fully addressed by conventional constructs, traditional financial institutions and the long-known financial products. The approach is thus characterized by openness to market innovations which can have a transformative role in expanding the scale and reach of financial services.

In the face of the many innovations, it is imperative for policy makers and regulators to fully understand the risks of these new solutions and models so that they can be assessed with precision and the risk mitigation can be properly calibrated. At the end of the day, even with new models, new players, and innovative linkages, all financial service providers should be properly and proportionately regulated to ensure financial stability, consumer protection and financial system integrity.

Founded on these guiding principles, many innovations have emerged which have demonstrated success. Innovations in product design and delivery channels boast of positive results in terms of sustained and expanded delivery of financial services. The succeeding sections will showcase how these principles are put into practice, through concrete examples of financial inclusion policies and regulations put forward by the BSP.<sup>3</sup>

<sup>3</sup> These are excerpts from Espenilla and Tayag (2011). *Innovative Solutions to Increase Access to Finance: The Role of Enabling Policy and Regulation*. Bangko Sentral Review

## ***Microfinance: A Success in Product Innovation***

Microfinance is defined as a broad range of financial services such as deposits, loans, payment services, money transfers and insurance products to the poor and low-income households, generally for their microenterprises and small businesses, to enable them to raise their income levels and improve their living standards (BSP, 2010). Apart from this definition, microfinance is seen as a methodology and technology which has proven that a properly designed product, aligned with the needs and capacities of the low income sector can be provided in a sustainable and viable manner.

In 2000, the General Banking Law mandated the BSP to recognize microfinance as a legitimate banking activity. This came at a time when microenterprises, and even small and medium enterprises (SMEs), faced the usual barriers in accessing credit – lack of collateral, voluminous requirements, lack of credit history, among others. Microenterprises often had to resort to informal lenders who exacted a steep price. Financial institutions were also wary of this market due to perceived high credit risk and transaction costs.

The BSP endeavored to create the environment to address these barriers. The main objective in the approach to bank-based microfinance is to enable the delivery of commercially sustainable microfinance in the banking sector where the government only provides a supportive role through policy, regulation and capacity building. Successful microfinance practices around the world were studied in order to set in place regulations that recognized and accepted best practices such as using group support or liability arrangements, cash flow based lending and high frequency amortizations that matched client's cash flow. This allowed traditional rural banks and thrift banks that were willing to adopt the new technology from technical assistance providers to legitimately transform their business model.

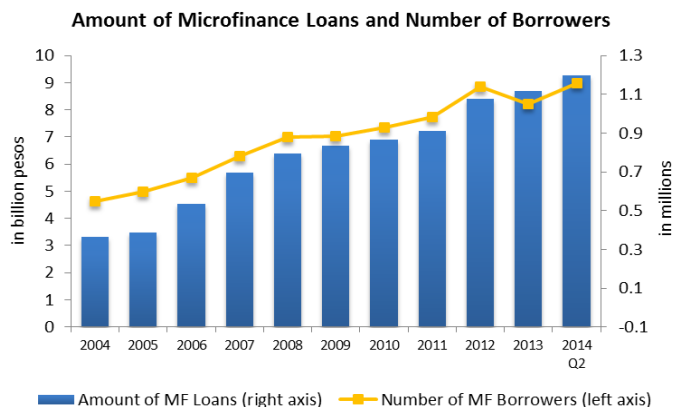
Entry into the banking system was also liberalized and created an environment that allowed new entrants into the market particularly through the establishment of microfinance-oriented banks which are licensed and regulated as regular banks but dedicate at least 50% of their loan portfolio in microfinance. This became an ideal vehicle for microfinance non-government organizations (NGOs) that wanted to transform into a formal financial institution which are able to mobilize savings from the general public. The further liberalization of branching regulations allowed for the establishment of micro-banking offices (MBOs). MBOs are “scaled-down” or simple branches that make it easier for a bank to have a presence in areas where it may not be immediately economically feasible to set up a full bank branch.

Many innovative products have been developed by the market to respond to the obvious demand for a wider range of products beyond credit or microenterprise loans. These include micro-agri loans, housing microfinance loans, micro-deposits and microinsurance. These products are built on the best practices of microfinance, such as frequent amortizations or payments based on client capacity and cash flow.

While these innovations have been allowed in the banking system, prudent standards have been instituted for the conduct of microfinance operations including the use of portfolio-at-risk to monitor and measure portfolio quality, in the context of risk-based supervision. This

approach has allowed bank supervisors to fully understand the risk profile of microfinance and not lead the banks to simply avoid exposure to this market.

The enabling environment for microfinance has led to positive results. At present, there are 183 banks with microfinance operations serving more than 1 million clients with an outstanding loan portfolio of PhP 9.28 billion. Compared to figures ten years ago, these figures translate to 180% growth in the volume of the microfinance loan portfolio and 110% growth in the number of microfinance borrowers.



Apart from the numbers, the BSP has received international recognition for the significant strides it has made in microfinance. For five years in a row (2009-2013), the Economist Intelligence Unit’s global survey on microfinance has ranked the Philippines as number one in the world in terms of policy and regulatory framework for microfinance and is consistently in the top 10 overall which includes other criteria such as institutional frameworks and stability.

***Electronic Money and Mobile Banking: Technological Innovations in Service Delivery***

The use of technology in delivering financial services holds the promise of massively bringing more people into the formal financial system. One such technological application is the use of mobile phones as channels to access financial services. The potential to reach new markets, together with the promise of increased efficiency and lowered costs, has demonstrated a significant potential to increase financial inclusion.

The opportunities are clearly present in the Philippines. The percentage of total mobile connections to the total population is 110% (GSMA, 2013), significantly larger than the banking penetration. According to a McKinsey (2010) study, a large percentage of the country’s unbanked has a mobile phone and nearly 60% of these unbanked mobile customers keep some form of savings and 13% borrow from various informal sources.

From a financial inclusion standpoint, these numbers present an enormous and possibly even transformational opportunity. For instance, it can provide a significant growth potential in terms of efficient and cost effective delivery of remittances from over 10.5 million overseas Filipinos amounting to USD 2 billion in monthly remittances (BSP, 2014).

The Philippine experience in mobile financial services is anchored on our electronic money (e-money) framework. E-money products, which are stored in a mobile phone or a card, are a pre-paid, low-value fund transfer mechanism which allows its holders to make purchases, send and receive e-money, pay bills and make other similar transfers electronically.

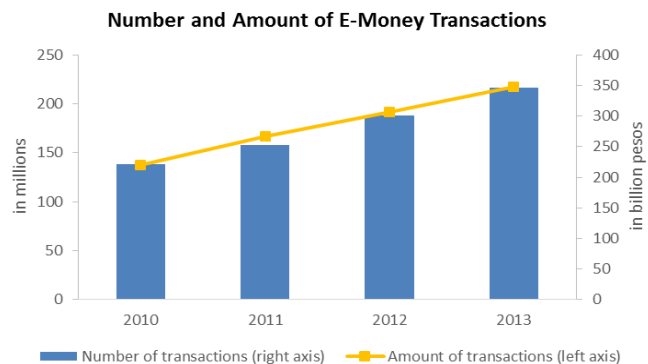
When our top two telecommunication companies approached us with their respective e-money products, the BSP endeavored to fully understand the products, the underlying technology and systems to appropriately identify the risks, the possible ways to address them as well as other issues. We undertook an open yet cautious approach by allowing pilot tests of the products. Only after 5 years (in 2009) did we issue our comprehensive e-money regulatory framework.

Our regulatory approach reflected our learnings from the pilot runs and careful consideration of the benefits and more importantly, the new risks and changing nature of risks on the issuer, its agent network and the users. At the core of our approach is the recognition that e-money is not a deposit - it is not booked as a liability, does not earn interest and not covered by deposit insurance. This approach enabled us to exercise a lighter supervisory and regulatory touch to entities we allowed to be established as e-money issuers (EMIs) and retain prudential regulation for entities that are deposit-taking.

Yet, cognizant of the risks, our regulations provided qualifications for EMIs (e.g., capital requirements, fit and proper standards, etc.), rules in the issuance of e-money (i.e., transaction limits, security features and consumer protection) and parameters in the development of e-money agent networks (i.e., anti-money laundering compliance). The regulation also addressed the potential entry of new players, provided for a clear and level regulatory framework and allowed for the orderly development of e-money.

Other regulations were set in place which complemented the e-money framework including the opportunity for banks to outsource the e-money activities. More importantly, our updated anti-money laundering rules and regulations aimed to overcome the barriers to customer onboarding especially for the unbanked. We recognized the possible tiering of clients based on risks. We also allowed banks to outsource or rely on customer identification by duly authorized agents that are located in unbanked communities. It therefore addresses the limitations of the existing physical reach of banks and lowers the cost in acquiring new customers. The decision to open accounts and provide credit still rests on the bank.

Our e-money framework has shown significant gains. There are now over 10,600 active e-money agents performing cash-in and cash-out transactions. For 2013, there were 217 million transactions with PhP 350 million in inflows and PhP 346 in outflows indicating that the accounts are being used as payments and transactional/ pass through accounts.



It is also worth noting that while only 26.6% of Filipino adults have a formal account (equivalent to 45 million deposit accounts), there are now 26.7 million e-money accounts that allow people to make financial transactions. This is significant considering that transactional accounts can become an effective on-ramp to a broader range of financial services.

## ***Moving Forward***

We will continue with our existing strategies to promote greater financial inclusion for all Filipinos. One of the major activities in the pipeline is the development of a National Retail Payment System which aims to establish a more efficient, competitive and inclusive retail payment system in the country. This is to address current limitations brought about by partial cross-channel interoperability, lack of transparency in pricing, among others. While such system may not be considered systemically important due to the relatively lower values exchanged, its inefficiency or failure will not go unnoticed as it affects the everyday lives of millions of Filipinos.

We are also working on the implementation of a Nationwide Baseline Survey on Financial Inclusion to measure access, usage, quality and welfare dimensions of financial inclusion, based on experiences of Filipino adults. Another important activity is the ongoing inter-agency consultation for the crafting of a National Strategy for Financial Inclusion which aims to provide a framework to enable the government and the private sector to take a coordinated and systematic approach in building an inclusive financial system.

We will stay engaged with ongoing global discussions on financial inclusion being put forward by the Alliance for Financial Inclusion (AFI), GPFI, SSBs, among others. The constant support and participation in global initiatives will highlight the BSP's continued commitment in promoting greater financial inclusion.