Establishing a Corporate Strategy to Develop a More Inclusive Financial System

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Policy Problem

The Bangko Sentral ng Pilipinas (BSP) has taken serious and deliberate measures to establish a supportive regulatory environment for market-based solutions that address financial access issues. Since the General Banking Law of 2000 recognized microfinance as a legitimate banking activity and mandated the BSP to set the rules and regulations for its practice within the banking sector, the BSP has issued over 20 Circulars and undertaken various initiatives for microfinance in particular and financial inclusion in general. These have resulted in over 200 banks providing microfinance services (from just a handful in 2000) reaching nearly one million households with an outstanding portfolio of PhP 7.3 Billion. Innovations in products and delivery channels using technology have also brought about advances in financial inclusion. The BSP and the Philippines have therefore been lauded globally for the significant strides it has made for microfinance and financial inclusion. For two years in a row, the Economist Intelligence Unit’s global survey of microfinance has ranked the Philippines as number one in the world in terms of policy and regulatory framework for microfinance and number two overall which includes other criteria such as institutional development and investment climate (an improvement from number 3 in 2009).

Despite the initial success, there is still much to be done. Widespread lack of access to financial services is still a pressing challenge. Only 26% of the adult population is banked. Approximately 37% of municipalities do not have a banking office. Existing banking services are biased toward higher income areas leaving much of the low income areas significantly underserved. For example, more than 50% of the country’s deposit accounts are found in the National Capital Region where bank density (number of people served by one bank) is 4,100 compared to the Autonomous Region of Muslim Mindanao (green) with 138,000. Coverage of municipalities in the NCR is 100% as compared to the 8% in ARMM. In a survey of mid-sized, non-metro cities, over 60% of the households still keep their savings at home. Many Filipinos, especially the poor, are therefore left wanting for much needed financial services.

Background

Financial Inclusion as a Worthy Policy Objective
The success of microfinance has demonstrated how a previously marginalized sector can be effectively mainstreamed and served in a sound and sustainable manner. Learning from the lessons of microfinance, the BSP endeavored toward a more ambitious and broader goal of building an inclusive financial system or expanding access to financial services for all. The BSP believes that financial inclusion is a worthy policy objective. It contributes directly to economic development and social cohesion and is therefore something that should be pursued alongside the promotion of financial stability.

*What has the BSP done?*

In 1997, the Philippines was one of the first countries to establish a clear National Strategy for Microfinance anchored on the principle of market-based microfinance policies. The emphasis was on the private sector to be the leading provider and the government to play a supportive role through policy, regulation, and capacity building. In 2000, the BSP declared microfinance as its flagship program for poverty alleviation to complement the mandate of the General Banking Law.

The BSP created, in 2002, a Microfinance Committee, Microfinance Unit, and a Microfinance Core Group (now the MicroSME Finance Specialist Group (MFSG)) began to focus on the development of an enabling policy and regulatory environment for microfinance. In 2007, the BSP was the first central bank in the world to establish an office dedicated to financial inclusion through the conversion of the Microfinance Unit into the Inclusive Finance Advocacy Staff (IFAS).

*Where are we now?*

The institutional set-up of the Microfinance Committee, Microfinance Unit, and Microfinance Core Group was instrumental in building a clear policy and regulatory framework for microfinance. The BSP has used this solid foundation to take additional strides towards financial inclusion. In the last twelve months, the BSP has established new issuances and specific measures that bear the potential of increasing access to finance in a significant way. These issuances ensure the following:

a. *Wider range of products* – BSP has recognized microenterprise loans, micro-agri loans, housing microfinance loans, microdeposits and microinsurance.

b. *Expanded physical network* – allows banks to establish micro-banking offices specifically designed to reach unserved or underserved areas.

c. *Expanded virtual reach* - creates the framework for an e-money ecosystem, which banks can use to transact with their clients in a more efficient and cost effective manner. This builds on the success of existing e-money products such as “Smart Money” and “G-cash.”
d. **Lower barriers to customer acquisition** - addresses a main obstacle (i.e. compliance with AML regulations) in serving the unbanked yet bankable by allowing risk based customer acquisition due diligence as well as outsourcing and relying on third parties for the required KYC in account opening.

Taken together, the BSP sees these recent issuances as groundbreaking measures that can unlock the potential of reaching the large populations of unbanked in our country.

**Where do we want to go?**

While much has been accomplished, more needs to be done. Moving forward, the goals and objectives of financial inclusion can be found in the recently approved Philippine Development Plan 2011-2016. In this plan, this inclusive financial system is characterized by the following:

a. The provision of a wide range of financial services (credit, savings, payments, insurance, innovative products) to serve the demands of different market segments;
b. The availability of financial products that are appropriately designed, priced, and tailor-fitted to market needs and capacities;
c. The participation of a wide variety of strong, sound, and duly authorized financial institutions utilizing innovative delivery channels to provide financial services to more Filipinos; and
d. The effective interface of bank and non-bank products/delivery channels, technology and innovation to reach the financially excluded.

**Analysis**

In light of the continuing need for financial inclusion initiatives, it is important to reflect on the current BSP initiatives as well as the structures for implementation to see how the objectives can be attained more effectively and meaningfully.

The following are the main units/bodies principally involved in financial inclusion issues:

1. The Microfinance Committee – This is the key driver of policy recommendations to the Monetary Board as well as the authority that approves various initiatives and activities related to financial inclusion. At present, it is comprised mainly of offices from the Supervision and Examination Sector with the IFAS as Secretariat. It does not include the other departments in the BSP which may also be involved in activities related to financial inclusion.
2. Inclusive Finance Advocacy Staff - The IFAS, which was previously the Microfinance Unit, is a lean office with a 3-staff complement benefiting from the inputs of a Microfinance Consultant. With the increasing scope of work related to financial inclusion, the IFAS has maintained its lean structure. While this has been effective to date, the current push for greater financial inclusion will require a more significant staff complement.

3. Micro-SME Finance Specialist Group – This is the specialist group in charge of supervision and examination of banks with significant microSME portfolios.

At present, the activities for financial inclusion include regulatory changes, advocacy initiatives, supervision concerns, and financial literacy efforts, among others. Aside from the three aforementioned bodies, some of these activities are currently being undertaken by other offices and departments within the BSP.

While this current portfolio of financial inclusion initiatives has achieved initial success, certain challenges remain that must be addressed to better implement the financial inclusion agenda. These challenges include the following:

1. Limited coordination – While the diversity of disciplines that are involved in financial inclusion allows for a richer output, much can also be lost when there is limited coordination. The lack of coordination oftentimes leads to the following:
   - Duplication of efforts
   - Under-utilization of technical skills and capacities that are otherwise already available within the BSP
   - Varying, or sometimes even conflicting, messages
   - Lack of the “big picture” view of the overall financial inclusion framework of the BSP.

2. Financial inclusion not as the core function – For a majority of the departments, work related to financial inclusion is not a core mission. Because of this, financial inclusion work is only afforded second-order priority. Proper follow-through and meaningful monitoring is often neglected. This results in pockets of financial inclusion work rather than a complete and coordinated effort.

Options

To continue with the push toward greater financial inclusion, the BSP may maintain the current set up since it has already been effective for the last 10 years. This will entail less cost and will also not necessitate organizational changes.

On the other hand, the BSP can implement an enhanced organizational and implementation set up that builds on existing success while addressing the current limitations.
**Recommendation**

The need for increased financial inclusion likewise demands a greater focus and more deliberate implementation strategy. Toward this end, the following implementation strategy is proposed:

**Guiding Principles**

In the implementation of the financial inclusion strategy, it is necessary to establish guiding principles to ensure the coherence and consistency of the approach. In this regard, the BSP Financial Inclusion Strategy is anchored on the following guiding principles:

1. Financial inclusion is a worthy policy objective and something that can be pursued alongside the promotion of stability and efficiency in the financial system.
2. Financial inclusion and financial stability can be mutually reinforcing. Household-based evidence has shown that access to financial services (i.e. savings, loans, insurance) has a positive impact in people’s lives, especially the poor. This creates a broad based foundation for the financial system. The benefits of a stable financial system are seriously constrained if it only serves a small portion of the population. Moreover, recent financial crises have underscored the negative effects of financial exclusion in the stability of financial markets and in economic development in general.
3. Financial stability and financial inclusion are not inevitable. Both demand at least the same measure of energy, imagination and serious attention.
4. In addressing financial access issues, market based solutions are not only feasible but preferable. Governments tend to be unsuitable providers of financial services and are instead better positioned to establish a supportive regulatory environment for the said market-based solutions to work. These solutions, of course, present real and valid risks but these are concerns that can be managed. Regulators must maintain an active dialogue with the market.

**General Approach**

Anchored in the above principles, the general approach for the Financial Inclusion Strategy is as follows:

1. Promote an enabling environment based on the proportionate application of sound and generally accepted regulatory and supervisory principles. It is important that all players and financial service providers are properly and
proportionately regulated to ensure consumer protection and financial system stability and integrity.

2. Enable the delivery of a wide range of services such as savings, credit, insurance, payment services and remittance. To reach all markets, including those that have been previously unbanked, these products must be appropriately designed and priced and delivered by institutions that have the authority and capacity to safely and effectively provide or deliver such services.

3. Allow banks and non-banks to leverage on linkages and partnerships to expand their range of products as well as their delivery channels to reach the financially excluded more effectively.

4. Facilitate useful innovations to operate in an environment where the risks associated with such innovations are adequately understood and addressed and where there is a judicious and proportionate application of sound principles.

Framework and Key Components of the Financial Inclusion Strategy

1. **Regulatory Changes** – Entails the crafting of the necessary enabling policies and regulations to build an inclusive financial system or the changing of existing ones in line with the objectives, as defined. Key components include policy research, market surveillance, and policy development.

2. **Effective Supervisory Capacity** – Involves the continuous training and capacity building of supervisory units involved in the various financial inclusion undertakings. This includes, among others, the MFSG, Core Information Technology Specialist Group (CITSG).
3. **Advocacy** – Includes complementary initiatives that promote and advocate for specific initiatives that contribute to financial inclusion such as, but not limited to, the Credit Surety Fund, various savings promotion programs, and programs that provide business development and business linkages.

4. **Communication** – Encompasses multi-stakeholder coordination including; a) other government departments/offices involved in financial inclusion, b) international fora/regional groupings (i.e. G20, APEC, ASEAN, Alliance for Financial Inclusion (AFI), CGAP), c) local public and private sector, d) media and e) general public.

5. These four components shall be well grounded with the foundation of a comprehensive and effective Financial Education and Consumer Protection Framework and a Robust Financial Inclusion Data Framework. The former recognizes that as financial inclusion efforts become successful, there is a greater need for the public, especially the new participants in the financial system, to be equipped with the necessary knowledge, skills, tools and mechanisms to ensure that they are adequately informed and protected. The latter will ascertain that progress can be effectively measured and that policies are truly evidence-based.

**Structure and Resources**

To build on existing success and address the current limitations, a proposed organizational and implementation set-up is recommended. This set-up can be used as a starting point for work and coordination on a national scale.

1. **Reconstitution of the Microfinance Committee as the Inclusive Finance Committee** – The reconstitution will now include the other departments involved in various work related to the key components mentioned in the previous section.

   In addition to the existing membership of the Microfinance Committee, other offices such as the Economic and Financial Learning Center (EFLC), Department of Economic Statistics (DES), Supervisory Data Center (SDC), Office of Supervisory Policy Development (OSPD), CITSG, and the Corporate Affairs Office could be included.

   This will provide a venue for synchronization of messages and coordination of initiatives.

2. **Expansion of the Inclusive Finance Advocacy Staff** – It is proposed that the technical team be increased to six (supported by administrative staff). The
technical team shall include individuals classified into three categories: a) strong research, writing, and analytic skills preferably with a background in economics, finance, or economic development, b) strong quantitative background preferably statistics or a degree that allows the ability to process, organize, and interpret large amounts of data, manipulate data, and interpret results, and c) project management experience.

IFAS is to oversee/ be involved in the following:

- Development and monitoring of an overall policy roadmap for financial inclusion.
- Data collection and analysis to benchmark the current state of financial inclusion, monitor progress, and measure impact. Work here will also be coordinated with DES, SDC and external data gathering bodies.
- Implementation of the recommendations of the recently completed technical assistance from the Bankable Frontier Associates.
- Local and International Stakeholder Communication and Coordination. This will include reaching a wider local and international audience, relating to media, participating in various relevant fora, and coordinating with donors and other government offices, among others.
- Implementation of various advocacy initiatives.
- Coordination with the relevant offices involved in consumer protection and customer redress.
- Involvement in the BSP Economic and Financial Learning Program.
- Internal technical/ substantive support to BSP officials on financial inclusion.
- Serve as an information hub of financial inclusion.