

**UPLAND DEVELOPMENT PROGRAMME (UDP)
IN SOUTHERN MINDANAO (EU Project: ALA-97/68)**

**THIRD ASSIGNMENT FINAL REPORT
OF RURAL FINANCE SPECIALIST
(June to November 2005)**

**Prepared by David M. Baillie
18 November 2005**

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MISSION DETAILS

Name of Project: Upland Development Programme (UDP) in Southern Mindanao

Project Reference: ALA/97/68

Country: Philippines Duty Station: Davao City

Duration: 120 person-days.

Report Title: Rural Finance Specialist (Expatriate) Third Assignment Report

Objectives: To provide support for UDP to complete the handover of the Rural Finance Services Scheme to Land Bank of the Philippines and the People's Credit & Finance Corporation and their client retail lending microfinance institutions as a sustainable operation together with workable loan model packaging arrangements for use in the field.

By: Discussions at the PMO and PPO levels and in Manila, review and use of background internal and external literature; meetings with Mindanao GFI, PFI, FSC and LGU officials, UDP staff and project beneficiaries; and report preparation.

TORs: Included in Annex 1

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ACKNOWLEDGEMENT

The Consultant wishes to thank the UDP Project and partner GFI and PFI staff for their support and assistance during the assignment input. In particular he would like to express real appreciation for the liaison work and commitment put in by the Rural Finance Services Component Coordinator, Elena M. Sollano, and for the guidance and advice provided by the Programme Co-Directors Dashiel P. Indelible and Wiebe van Rij in what was expected to be the last year of UDP RFS operations.

This input followed major efforts made to push through LANDBANK and PCFC acceptance and operation of the UDTF and UMTF programs. Within LANDBANK, I particularly wish to express my appreciation for the patience and understanding of their Mindanao Branches Group staff and the ever hard-working UDTF IB Secretariat Team, while within PCFC thanks is due to its finance negotiating team.

EXECUTIVE SUMMARY

In line with the broad requirements outlined in the Terms of Reference, the following issues have been addressed and actioned during the assignment undertaken on an intermittent basis between 1 June and 18 November 2005:

- Preparation of Assignment Workplans submitted to the Co-Directors and RFS Team and finally updated on 11 July 2005.
- Acting twice for the Technical Assistance Team Leader/European Co-Director during his absence from 10 June to 10 July and 25 October to 14 November 2005
- Preparation of an independent internal assessment of the progress made to 31 July 2005 on the UDTF Institution-Building program submitted to the UDTF Steering Committee on 26 August 2005.
- Introduction in July 2005 and follow through of essential efforts to ensure FSC books of account were updated and closed and UDLF accounts at PFIs are finalized and audited.. Where possible any remaining FSC assets and liabilities are being transferred to parent cooperatives.
- Preparation of draft terms of reference and contracts for the final auditing of PFI UDLF accounts
- Preparation at the request of LANDBANK of an additional UDP/LANDBANK Memorandum of Agreement and internal administration procedures to cover the collection arrangements for UDLF Loan Accounts.
- The drafting of amendments to the UDTF Memorandum of Agreement (MOA) to better match it to field requirements and streamline the Trust Fund Steering Committee process through the establishment of a single National DA/EC Trust Fund Steering Committee.
- Drafting and securing the eventual signature of the Upland Microfinance Trust Fund Memorandum of Agreement, Trust Agreement, and Operating Guidelines & Procedures under which the UDP-PCFC Special Financing Programme will continue after UDP closure.
- Briefing and liaison with the visiting independent UDP Pre-Completion Review Mission including the supply of RFS data and statistics. Representation of TA team at PCR wrap-up and final presentation meetings in Davao and Manila
- Review of final documentation for the Loan Model Package (LMP) system with the UDP Sustainable Agricultural (SAD) Team to ensure its further regular technical updating and use in the model farm demonstration system. Liaison with the LANDBANK UDTF IB Service Provider handling cooperative financial intermediation training to ensure all cooperatives are aware of the value of LMPs in predicting profitability/loss of individual micro-enterprises. Preparation of the draft and this final report.

The late but essential 18 month extension granted by EC to UDP will now mean that UDP will be able to further influence contents of the UDTF/LANDBANK and UMTF/PCFC programs. In particular better integration of the introduction of diversified farming systems (DFS) methodologies through the use of LMP systems by the major UDTF rural banks and cooperatives and PCFC MFIs will be targeted.

1. INTRODUCTION

This report covers the assignment of the Rural Finance Specialist (Expatriate) undertaken in the months of June to November 2005¹. The 120 day assignment was split up into four distinct periods to better match the supervisory needs of the Rural Financial Services (RFS) Component closure program.

The initial Terms of Reference (TORs) for the consultancy input were modified on the 11 July 2005 by the Co-Directors at the Specialist's request when it was discovered that FSC and UDLF closure plans had fallen six months behind schedule and required urgent additional direction. During the same period, uptake of the Local Model Package (LMP) had been stymied within the partner financial institutions (PFIs) and microfinance institutions (MFIs) involved as a result of their concentration on other activities considered to be more urgent. The modified TORs are attached as Annex 1.

The Specialist acted as signatory for the European Co-Director for the periods 10 June to 10 July and 25 October to 13 November 2005.

Despite Department of Agriculture (DA)/European Commission (EC) agreement in October 2005 that UDP will be extended by 18 months until 17 July 2007, direct RFS Component involvement in the operations of the Upland Development Trust Fund (UDTF)/LANDBANK and Upland Microfinance Trust Fund (UMTF)/PCFC is expected to be limited to monitoring and liaison only from 1 January 2006. By that time LANDBANK and PCFC should have fully taken over all RFS Scheme responsibilities provided no further substantial handover problems emerge.

2. INTERNAL ASSESSMENT OF PROGRESS MADE ON UDTF IB PROGRAM AUGUST 2004 TO JULY 2005

In compliance with the requirements of EC Delegation for an evaluation to be undertaken by an expatriate specialist as a pre-requisite to approving the 2nd semester UDTF budget, the Consultant undertook the fieldwork and necessary consultations in conjunction with UDP RFS staff and the UDTF IB Secretariat. The eventual findings were presented to the UDTF Steering Committee on 26 August 2005. The 2nd Semester budget was subsequently approved.

Taken overall, the principal constraints facing the IB Program were the late formulation of approved IB Program training modules and a five month January to June 2005 delay in the mobilization of external NGO Service Providers needed to undertake the necessary strategic planning required by new cooperatives. Both significantly held up FSC member fund transfers to the new parent cooperatives as well as new member recruitment from other householders in the area.

As at 31 July 2005, only 2,723 FSC members (36%) of the 7,531 recorded in June 2004 in the 82 FSCs being handled at present had been absorbed into Model 1 and Model 2 cooperatives reflecting substantial shortfalls in community organization achievement. By the same date however, Php 2.463 million had been paid up as cooperative membership capital by former FSC members, Php 1,694 in excess of their Php 2,461 recorded as FSC CBU in June 2004. This indicated then that the

¹ Input dates: 1 June - 22 July; 8–26 August; 5-9 September; 3 October - 3 November and 6-18 November 2005.

active 36% of former FSC members have raised substantially more new money to join the cooperatives concerned

LANDBANK MBG response to the assessment was essentially positive. Changes in working systems were agreed although the offer for the field staff cadre to be expanded was not accepted. LANDBANK instead requested more time to implement their existing program and for another assessment to be undertaken in 2006. At the time of writing this report, IB program operations had picked up significantly with the fielding of the essential NGO Service Provider team handling cooperative strategic planning and cooperative financial intermediation (akin to microfinance) as well as the implementation of many operational improvements. This was resulting in a substantial improvement in staff and beneficiary morale.

The actual assessment paper submitted by the Consultant to the UMTF Steering Committee, the recommendations made and the Steering Committee responses are set out in Annex 2.

3. UDLF & FSC ACCOUNTS CLOSURE AND UDTF TAKEOVER

In the 18 month period since the signature of the UDTF Memorandum of Agreement on 21 March 2004, the UDTF credit component program has been implemented in three phases:

- Phase 1 – 21 March to 21 September 2004. Consultations with PFIs/FSCs – UDP investment funds available at 0% interest
- Phase 2 – 22 September 2004 to 30 June 2005. All UDP SCFs and UDLF investment funds not repaid reclassified as loans charged at 6% per annum interest – a nine month interim period to allow PFIs to collect in SCFs still with PFIs and to facilitate eventual UDTF refinancing/restructuring of any outstanding UDLF loan balance by 30 June 2005. New UDTF lending to LANDBANK bank-assisted cooperatives not previously UDP PFIs was charged at 12% per annum.
- Phase 3 – 1 July 2005 to onwards. New UDTF lending charged at 12% per annum market rate. Past due UDLF loans expected to be charged at 6% per annum + a penalty charge of 2% per month. It should be noted that the imposition of the 2% per month penalty was imposed to facilitate prompt repayment and as a punitive financial disincentive to discourage default.

3.1 UDLF WIND-UP STATUS BY 31 OCTOBER 2005

Despite the deliberate phasing outlined above which allowed more than one year for UDLF wind-ups to proceed, during the September 2004 – June 2005 period and unknown to UDP LANDBANK MBG instructed its staff not to intervene and close/transfer FSC accounts when formulating new cooperative accounts as its management was not willing to accept any UDLF accounts with any unresolved issues pending. At the same time PFIs would appear to have been inactive as they were uncertain as to how to proceed as they stressed that the following problems needed resolution before UDLF repayments or restructuring/refinancing could proceed:

- PFIs are legally prevented from repaying FSC Seed Capital Funds (SCFs) invested to the UDLF to the UDTF as a third party as BSP regulations require FSCs to sign a waiver of ownership rights to SCF investments in their UDLFs as they were physically deposited in the name of the FSC. In line with the originally approved RFS Scheme, SCF funds invested with and still retained by FSCs were paid directly to them without collateral and not via

PFI for onward disbursement to FSCs. In the absence of official receipts, PFIs therefore have no legal responsibility for the repayment of such funds despite the inclusion of this function in the UDLF Implementing Guidelines annexed to their UDP/PFI UDLF Trust Agreement.

- No effort has been made by UDLF Steering Committees to direct FSCs to collect in non-collateralized SCF funds still recycling as loans within their memberships. FSCs have not signed any document to accept the changes made with the establishment of the UDTF requiring the SCF collection and payment to the UDLF/UDTF. Most will accept a transfer of UDLF assets & liabilities to their new parent cooperative but are reluctant to repay them to the UDTF as there is no guarantee they will be able to access them again
- FSC accounts have not been adequately maintained (under PFI supervision) in the majority of cases. All such accounts require updating before they can be closed and any transfers of assets/liabilities made to parent cooperatives.

As a result of major UDP RFS and UDTF IB Secretariat team efforts to resolve these constraints, PFI repayments were beginning to move by the last quarter of 2005. At 31 October 2005 MFMC and NICO had substantially repaid UDLF outlays on a voluntary basis and Money Mall RB and RBDI had repaid more than half of the amounts due. However two rural banks and four cooperatives are yet to make any substantial payment.

At 31 October 2005 total of Php 7.570million (20%) of Php 37.114 million UDLF collectables had been repaid. No UDLF restructuring / UDTF refinancing loans was however forthcoming from LANDBANK.

Because of their late (August 2005) request for an additional MOA to cover UDLF payments (see 3.3 below) and the subsequent delays caused in implementing their new provisions, LANDBANK has yet to instruct its Accounts Officer staff to pursue payment. Such instructions will be forthcoming in December when final PFI UDLF audits are completed.

3.2 UDLF Wind-up Actions Taken by UDP

Having recognized on his arrival at UDP in June 2005 the need for urgent resolution of these issues to ensure closure on time of all FSC and UDLF accounts, the Consultant recommended, UDP approved, and the UDP RFS & FAD Team jointly implemented the following actions:

- Employment 16 roving bookkeepers to update FSC accounts and reconcile all FSC-PFI financial transactions during the months of August & September 2005. On completion of this exercise, all FSC UDP-related accounts were being reviewed in October/November by a joint team of UDP FAD & RFS staff, the local UDTF IB Specialists and FSC BODs at meetings in the field held to process their closure. In winding up the accounts, FSC members' savings and CBU were first paid out and where feasible any remaining assets & liabilities including unpaid SCF funds transferred to the accounts of their new parent cooperatives. The necessary template for the FSC Waiver of UDLF ownership rights was drafted by the Consultant in June 2005 and distributed by UDP to FSCs.
- Processing for the engagement of independent auditors in November/December 2005 to audit the final UDLF accounts of PFIs. The auditors will mediate on disputed items claimed as allowable UDLF expenses. The remaining UDP financial exposure within the corrected

accounts constituted the final basis for all UDLF loan commitments after re-classification of the specific funds involved as follows:

- All UDP capital directly invested in individual UDLFs less UDP-shared losses recorded in PFI UDLF audited final accounts submitted by individual PFIs to UDP was classified as past-due loans from 1 July 2005 requiring formal collection or restructuring action by LANDBANK MBG.
- All UDP-sourced SCFs invested by FSCs in UDLF were classified as past-due loans requiring formal collection or restructuring action from the date of signature of the FSC BOD Resolution Waiver authorizing PFIs to pay them into the UDTF
- All UDP-sourced SCFs remaining in FSC accounts were checked but NOT classified as UDLF past-due loans. Hence they will NOT be subject to interest or penalty payments. This reclassification was brought about as no security was available on these funds and FSCs were disputing the legal right of UDP to order their collection. Their payment into cooperative accounts is seen as the only viable alternative to write-off. LANDBANK MBG will be notified of the eventual amounts of FSC SCF assets & liabilities transferred into parent cooperative accounts for information purposes only.

3.3 Preparation and Introduction of UDP/LANDBANK UDLF Collection Memorandum of Agreement

With effect from 5 July 2005, UDP LANDBANK MBG received authority from EC, DA and the LANDBANK President & CEO to undertake collection of the financial exposure of UDP to PFIs. However, at the 26 August 2005 Steering Committee meeting LANDBANK MBG for the first time requested the production of a further MOA to be signed by UDP and LANDBANK MBG stipulating the actions to be taken by both parties and hence ensuring it did not take on any unresolved disputes.

This MOA was immediately drafted by the Consultant but only approved by LANDBANK on 2 November 2005. At the same time and at LANDBANK's request, the Consultant also drafted attendant procedural guidelines for LANDBANK collection of loans/investments from PFIs.

4. UPDATING / AMENDMENT OF THE CONTROLLING UDTF MEMORANDUM OF AGREEMENT

The original UDTF MOA was signed on 22 March 2004. Since its signature a number of anomalies have developed which require resolution through its amendment. These include:

- Updating of sections already modified with Steering Committee approval.
- Deletion of the sections related to assigning its future ownership. As joint Trustors neither DA nor EC can unilaterally withdraw the funds which therefore will remain only usable in the project area for the foreseeable future.
- The addition of a clause to sanction Steering Committee approval if required to move funds between the credit and IB accounts to match actual needs after UDP closure.
- The establishment of a new overall National DA/EC Trust Fund Steering Committee to cut TF supervision costs. UDTF will report to this committee while retaining its own Secretariat

As no further UDTF Steering Committee was held during the September to November period, it was not possible to push through the suggested changes. A Briefing Note explaining and specifying the proposed Draft Addendum clauses is attached as Annex 3.

5. PREPARATION AND SIGNATURE OF UPLAND MICROFINANCE TRUST FUND DOCUMENTS

As requested, the Consultant completed the whole process of redrafting the UMTF Memorandum of Agreement between DA, EC and PCFC, as well as the UMTF Trust Agreement between DA, EC and LANDBANK Trust Banking Group, and the necessary UMTF Operating Guidelines & Procedures with all parties.

The UMTF will take on the operations of the existing UDP-PCFC Special Financing Agreement. Its transformation into a trust fund is being facilitated simply to secure the availability of these credit funds in the UDP project areas after its closure.

Final MOA signature was delayed in October due to queries raised by LANDBANK on the financial health of PCFC. The EC Delegation subsequently requested and received proof of PCFC viability from PCFC and the Asian Development Bank to clear up the matter.

At the time of writing of this report document signature by DA, EC and LANDBANK TBG of all documentation was on-going.

6. PRE-COMPLETION REVIEW MISSION LIAISON

The RFS Team and the Consultant worked extensively with the UDP Pre-Completion Review Mission during the period 10 October to 7 November 2005.

In the absence of the European Co-Director, the Consultant represented the TA Team at both the PCR Mission presentations made first to the UDP and later to DA/EC in Manila. As the notification of EC agreement for an 18 month extension of UDP came during their initial fieldwork period, the PCR also prepared recommendations for 2006-7. In the light of the new-found security of continuing financing generated by the UDTF and UMTF trust funds, the Mission proposed that RFS efforts in 2006-7 should reinforce efforts to implement and consolidate diversified farming system lending through the wider use of the Loan Model Package (LMP) system.

7. FURTHER WORK ON THE LOAN MODEL PACKAGE SYSTEM

In the absence of the Consultant during the period October 2004 to June 2005 only minor use was made of the LMP kits distributed in September 2004 to LANDBANK and four interested local financial institutions. Because of the then impending closure of UDP, the Consultant's priority was shifted to winding up FSC and UDLF operations and finalizing UDTF and UMTF operational arrangements. Little time was therefore available to further promote LMP adoption.

During June 2005, the Consultant was able to confirm that no evaluation of the LMP materials supplied by him was undertaken by LANDBANK Development Assistance Department. LANDBANK lending policy currently requires all wholesale agricultural production loans made to cooperatives to be linked to the availability of a guaranteed market for any output. Although LANDBANK is embarking on a microfinance introduction initiative, little own-finance has been

committed in this sector to date. Within the Mindanao context, this policy direction particularly favours the approval of major loans for plantation crop production, while diversified lending is essentially discouraged.

Regrettably CAMTRIMCO, the only local cooperative financial institution targeted for LMP piloting, sacked its Mati Branch Manager who was handling LMP introduction in early 2005. No chance is seen for reviving this effort as the cooperative was the focus in November 2005 of attempts to secure its very survival.

All was not lost however on the cooperative front. During UDTF IB Program meetings, the Consultant was able to introduce the LMP approach the field team provided by AFFIRE, the service provider contracted in by LANDBANK to train Model 1 & Model 2 cooperatives in cooperative financial intermediation (akin to microfinancing). The LMP concept was enthusiastically received by AFFIRE whose team intend to implement its use in their own service areas in Leyte adjacent to their Head Office and to use its principles further in their UDTF Model 1 & 2 cooperative training inputs

The two PCFC MFI NGOs originally approached, Ad Jesum Development Foundation and the South Cotabato Foundation are still showing interest but have been diverted from introduction by their own area expansion and core business consolidation efforts. However, Enterprise Bank Inc., the only rural bank originally chosen, has made substantial progress in introducing its own agri micro lending initiative and is expecting to make considerable use of the LMP concept within 2006.

As more time for LMP introduction is now available within the UDP 18 month extension period to put LMP and the UDP upland development models developed within its other Components into practice, it is expected that the UDP SAD and RFS teams will in future work together on its integration as a support mechanism for the pivotal DFS initiative.

ANNEX 1

TERMS OF REFERENCE (MODIFIED 11 JULY 2005) RURAL FINANCE SPECIALIST (EXPATRIATE), 2005 MISSION

1. Updated Tasks of the Consultant

1. Assist PMO and PPO staff with the wind up of FSC UDP-related operations. Such assistance shall include but not be limited to: the conduct of consultations with FSCs and PFIs to facilitate a full understanding of the process; the drafting of contracts for additional bookkeepers to reconcile and update FSC accounts by 30 September 2005, and the wind up and transfer of these accounts to the new parent cooperatives by 30 November 2005 at the latest.
2. Conduct an internal assessment of the UDTF IB implementation within June/July 2005 in compliance with the requirements of the EC Delegation for the approval of the 2nd semester UDTF budget
3. Facilitate the completion of GOP/EC negotiations to finalize the need for continued management and use of UDP funds within the UDTF upon UDP closure (from 1 January 2006).
4. Facilitate the establishment of a Trust Fund with the PCFC similar to the UDTF administered by LANDBANK.
5. Assist partner financial and microfinance institutions in modifying the loan model package (LMP) formats where requested to match their requirements
6. Take up any other assignment in the context of these TORs given by the Co-Directors of UDP
7. Submit a draft report at least two weeks before departure to allow for the inclusion of PMO/PPO comments in the final document.

2. Duration and Period

Four (4) months within 2005 spread over a 6 or 7 month period.

ANNEX 2.

UDTF INSTITUTION BUILDING PROGRAM, UDP INTERNAL ASSESSMENT – AUGUST 2005

A2.1 UDTF IB Program Status and Constraints

1. The IB Program experienced usual but not excessive start-up delays, and fieldwork is already steadily progressing. New cooperative development is a slow process taking at least two years to establish true sustainability even in the best of circumstances. The principal issues assessed therefore are related to IB Program effectiveness and efficiency.
2. Moves necessarily undertaken in 2004-5 to ensure UDP RFS conformity with new GOP Rural Finance policy proved in themselves an immediate constraint to IB Program effectiveness. Morale amongst target beneficiary FSC members, PFI managers and UDP staff fell significantly during this period. The change from UDP provision of loan investment finance at zero cost to

PFIs and FSCs and its eventual gradual withdrawal and replacement with loan funds chargeable at full market rates has significantly increased lending costs for PFIs and will reduce loan uptake levels by them beyond their current levels of UDP financial exposure.

3. From June 2004, only five of the 12 PFIs involved in the RFSS (MAMPCO, NICO Money Mall RB, MFMC and RBDI) substantially complied within their contractual obligations to supervise FSC operations and accounts. At 30 June 2005 only 37 of 98 FSCs had fully reconciled accounts and financial statements. Many of the remainder were experiencing difficulties in paying out FSC members' savings and CBU for use as share capital contributions in their new parent cooperative. UDP took action to rectify this situation with the engagement of teams of bookkeepers (which completed all necessary updates within period August to October 2005.)
4. The UDTF IB program started operations on 2 August 2004 with the establishment of the UDTF Secretariat. Although managed by LANDBANK MBG, the IB Program is run on a totally autonomous basis with all staff employed on contract. The Senior Vice President/Head of the LANDBANK MBG acts as the IB Program Manager and its sole Executive Officer. To minimize the need to set up new operating procedures, LANDBANK day to day operational systems have been used from the outset with modifications only being made to suit perceived special UDTF requirements.
5. Progress with IB Program implementation during Q4 2004 to Q1 2005 fell short of original plans as is the norm with any new program. UDTF staff recruitment & training and essential procurement of motorcycles and office machinery was however completed quickly by mid-September 2004, and IB Specialists began cooperative community mobilization membership training immediately. The principal delays arose through late approval of the standard training modules to be used (finalized in February 05), late DA and EC endorsement of the 2005 Budget, the subsequent preparation of the complex 2005 Institution Building Intervention Plans (March 2005), and the eventual selection and engagement of contract strategic planning workshop and microfinance IB Service Providers. (May and July 2005 respectively).
6. Improvements were still being made to the first version of the UDTF IB Secretariat management information system (MIS) which will be completed in November and will include all essential evaluation materials. These were not available for review during this assessment.
7. UDTF MOA provisions require the use of LANDBANK procedures only for lending operations. Since UDTF IB Program start-up, strict adherence to the standard LANDBANK field operating procedures further constrained field staff contacts with the FSCs /cooperatives. In particular:
 - At the field level each visit made by a LANDBANK employee or IB Specialist is covered by a Call Report without which bimonthly salaries cannot be collected. Such Call Reports are prepared in addition to MIS data collected and dispatched monthly to the UDTF IB Secretariat thereby effectively almost doubling necessary reporting requirements. In the remote barangays where UDP operates, IB Specialists still have to obtain 3 quotations for any training venue or catering requirement which is extremely difficult and time-consuming. Repeat contracting is however permissible.
 - To facilitate economies of scale, IB Specialists are required to ensure participants from a minimum of three cooperatives are included in each training session despite their

remoteness from each other. Lapse times involved in ensuring adequate notification to ensure adequate attendance are substantial.

- IB Specialists can only obtain cash advances for a single training course after which a minimum of 2 weeks is needed for liquidation of expenses. Speedy implementation of the minimum of 3 and maximum of 12 training courses needed to complete the process from registration to eventual LANDBANK accreditation at the Development Assistance Center (DAC) level is difficult.

Taken overall at least 40% of IB Specialist time was estimated to be spent on these administration/report writing/financial issues)

10. UDTF staff operational efficiency is further hampered by the centralization of all executive and financial responsibility for IB Specialist operations with the Head of the Mindanao Branches Group. Regional Managers normally fulfill this role within LANDBANK's own IB operations.
11. With a total of 82 FSCs and 37 cooperatives in the current IB Program, each of the 5 IB Specialists has to handle an average of 16 FSCs and 7-8 cooperatives, all of which are very widely dispersed over the areas under their jurisdiction and often with no direct communications between them. IB Specialists therefore use up more than 15% of their working hours traveling. Rising gasoline costs are also limiting travel potentials. **The net result of these constraints is an inability of IB Specialists and LANDBANK staff to visit each cooperative more than an average of 2-3 days per month – too short a period of time to generate real membership expansion and ensure confidence in the program.**
12. Slow Model 1 & 2 membership buildup and progression of Model 2 cooperatives from registration to accreditation are the principal constraints. As at 31 July 2005, only 2,723 FSC members (36%) of the 7,531 recorded in June 2004 in the 82 FSCs being handled at present had been absorbed into Model 1 and Model 2 cooperatives reflecting substantial shortfalls in community organization achievement. By the same date however, Php 2.463 million had been paid up as cooperative membership capital by former FSC members, Php 1,694 in excess of their Php 2,461 recorded as FSC CBU in June 2004. This indicates that the active 36% of former FSC members have raised substantially more new money to join the cooperatives concerned
13. Amongst newly established cooperatives, each cooperative must finish a program of training courses involving modules on Strategic Planning (Workshop), Membership Expansion, Capital Build-up & Savings Mobilization, and Leadership & Management, as well as raise a minimum of Php30,000 in share capital and employ a professional bookkeeper in order to be able to successfully complete the accreditation process. At 31 July 2005, of the 37 parent Model 1 & 2 cooperative were registered with CDA but only 12 (4 PFIs, 4BACs & 4PNACs) of the 17 targeted for accreditation were fully LANDBANK accredited. Within the 19 new Model 2 cooperatives, 10 (52%) had completed strategic planning. Leadership & management training has been the principal focus of September and October training efforts. Q3 efforts to employ professional cooperative managers for Model 2 cooperatives have failed so that a fall-back position of using roving professional bookkeepers will remain the norm. 11 (58 %) of Model 2 cooperatives can be expected now to secure LANDBANK DAC accreditation by the end of 2005.

14. LANDBANK DAC Accreditation of cooperatives does not in itself guarantee the forthcoming availability of loan finance from LANDBANK Lending Centers. Although undertaken in liaison with DAC personnel, LC loan processing requires a full reassessment of credit absorptive capacity by different staff and more particularly a thorough review of potential markets if production loans are required.

15. No re-evaluation of FSC potential inclusion in Model 1 integration and in the Model 2 for amalgamation was undertaken by the IB team in the Q4 prior to Model 2 cooperative start-up. Problems are developing on the validity of specific parent Model 1 cooperatives being pursued for FSC absorption. In particular:
 - MFMC (a UDP PFI) has indicated it is now unable to absorb the members of its 8 FSCs as full cooperative members but will continue to support them as informal institutional members. All 8 FSCs have requested that their present successful linkage arrangement be continued as neither Model 1 nor 2 fits their present circumstances.
 - CAMTRIMCO, the most heavily indebted UDLF PFI with Php 7.873 million still outstanding was excluded from the IB Program with the agreement of its previous management as all FSCs were to be elevated to branch status. Earlier this year there was a complete management shake-up with the appointment of a new General Manager who has curtailed the new branch expansion and is now seeking IB Specialist assistance to start the FSC member absorption process.
 - MAVADECO (a UDP PFI), is unlikely to be able to avail of new UDTF loans because of a continuing LANDBANK past-due loans history.
 - A further 7 Model 1 potentially newly creditable cooperatives (PNACS) are poor-performing and unlikely to be accepted for LANDBANK accreditation until early 2006 at the earliest as they have not successfully completed the necessary 7-12 training modules.

16. Five Model 2 cooperatives were started up with less than an aggregate of 75 FSC members and hence questionable potential viability from the outset. At 31 July 2005, 11 Model 2 cooperatives had under 100 members and were showing little scope for recruitment acceleration.

17. No IB assistance of any type has been given to date to the five rural bank PFIs (Money Mall RB, RBDI, RBDARBCI, SRBI, & RBTI) previously serviced by UDP.

18. As at 31 July 2005, Php 7.263 million (19%) of the Php 34.729 million financial exposure of UDP with PFIs had been repaid. Despite the generous provision of the 9 month interim transition period (22 September 04 – 30 June 05) to facilitate UDP financial exposure refinancing, no single PFI approached LANDBANK for a UDTF loan to refinance these debts as originally conceived. LANDBANK Lending Center staff instead concentrated on processing wholly new loans for BACs and one (PFI) rural bank (SRBI). Php 15 million in new UDTF lending was approved and 9.658 million released to five cooperatives only one of which was a former PFI requiring funds for microfinance (MF) whose existing UDP financial exposure remains unpaid. MF loans still account for the vast majority of FSC / UDLF lending. All PFIs are expected to suffer financially from this inaction as all UDLF past dues from 1 July 2005 are subject to a 2% per month additional penalty interest rate.

A2.2 Recommendations and UDTF Steering Committee Responses

The Rural Financial Services Component remains one of UDP's highly publicized initiatives. Real progress must therefore be seen to be made in 2005-6 within the LANDBANK-managed IB Program if the overall acceptance level of the initiatives being made in other UDP Components is not to suffer. The following changes were recommended and *Steering Committee responses outlined in italics*:

1. UDP complete the wind up and closure of all FSC UDP-related accounts as soon as possible but not later than 31 October 2005. This should facilitate the payout of all due FSC member savings and CBU funds. UDP-sourced Seed Capital Funds still held by FSCs have little chance for collection unless, FSC assets and liabilities are transferred at FSC accounts closure to their new parent cooperatives. *Recommendation accepted*
2. LANDBANK as a matter of urgency visit all 11 former PFIs to ensure all their UDP financial exposure is refinanced with UDTF or other loans as soon as possible but not later than 30 November 2005 to accelerate UDLF account closure. UDP financial exposure with PFIs and FSCs is all unsecured while UDTF loan security requirements follow LANDBANK requirements. No PFI can afford the 6% interest per annum and punitive 2% per month (24% per annum) UDLF rates. *Partial acceptance as LANDBANK stipulated they would only accept UDLF accounts if and when a new UDP-LANDBANK MBG MOA on UDLF handovers was drafted and signed, and all outstanding issues with any one PFI had been cleared up by UDP*
3. LANDBANK/UDTF take steps to be completed by 1 September 2005 at the latest to reconstitute UDTF internal operating procedures to:
 - require UDTF IB Specialists to submit minimal monthly reports in lieu of fortnightly call reports while still complying with monthly MIS data submission deadlines *Not accepted by LANDBANK MBG*); and
 - devolve executive responsibility to the LANDBANK Regional Manager level for IB Specialist cash advances/liquidation relating to training activities included within Semestral budgets approved by the Steering Committee. *Not accepted – LANDBANK instead agreed to review and approve IBS needs monthly.*
4. LANDBANK/UDTF recruit an additional three Community Organizers to assist IB Specialists with effect from 1 October 2005 each for a period of 6 months to speed up membership recruitment and the provision of cooperative training programs. This input is seen to be essential to improve actual times spent by IB staff with former FSCs/cooperatives in the field and to accelerate member recruitment rates. New staff should be provided with a motorcycles returned to UDP but share usage of the existing UDP-supplied computer sets at LANDBANK. Actual reallocation of IB Specialist areas of responsibility should be left with LANDBANK DAC Heads. *Not accepted by LANDBANK MBG. Instead they requested that this need be assessed again in early 2006.* Efforts to recruit permanent roving bookkeepers for Model 2 cooperatives should begin immediately while recruitment of cooperative managers should be rescheduled to be better synchronized with the start up of cooperative lending activities *Recommendation accepted*

5. Include CAMTRIMCO as a Model 1 cooperative within the Q4 program to provide essential additional IB support and better monitor its management of its Php 7.873 million UDP financial exposure. *Steering Committee recommended and UDP accepted that the UDP local Microfinance Specialist TA be sent to work with CAMTRIMCO to speed this process.*
6. UDTF institute the following changes in reallocating unsuccessful Model 1 FSCs to other mechanisms.

| No of FSCs | Former Model 1 Parent | Suggested Arrangement | Comments |
|------------|-----------------------|--|--|
| 8 | MFMC | Remain as informal institutional members. <i>Accepted</i> | Do not exceed former MFMC Model 1 budget |
| 1 | TIAC | Reform as new Model 2 cooperative. <i>To be considered by LANDBANK MBG</i> | FSC too far from cooperative |

7. The UDTF Secretariat should warn the following Model 2 cooperatives in the following locations which show little scope for continuation due to poor membership recruitment that they will be dropped from the IB Program by 31 December 2005 if they are unable to reach a target of 150 regular & associate members by that date. *Recommendation accepted but with a reduced total of 100..*

| Model 2 Coop | No of Original FSCs | No of Members | | Comments |
|----------------------------|---------------------|---------------|--------------|----------|
| | | FSC 30Jun04 | Coop 31Jul05 | |
| MBSC, Mabini, CV | 1 | 58 | 27 | |
| CAMUPCO, N. Bataan, CV | 1 | 228 | 65 | |
| CUFAMPCO, Mabini, CV | 1 | 92 | 98 | |
| LUDOUCO, Lupon, DO | 1 | 377 | 56 | |
| TFCC, Tarragona, DO | 1 | 118 | 26 | |
| LDMMPCC, Don Marcelino, DS | 4 | 178 | 30 | |
| JASLUMPC, JAS, DS | 4 | 219 | 60 | |
| KIMALAKA, Malungon, SP | 1 | 36 | 73 | |
| LAFARCO, Glan, SP | 2 | 28 | 59 | |
| MALAUMON, Glan, SP | 2 | 92 | 34 | |

8. UDTF immediately impose minimum targets to be reached within specified time periods by cooperatives commensurate with the type of training offered:
 - Pre-Membership Education Seminar/ Membership Education Seminar – Minimum of 150 members within 6 months
 - Strategic Planning – Minimum of 1 viable cooperative commercial activity started within 6 months in addition to savings mobilization and credit

Should any cooperative not fulfill these targets, continuation of UDTF IB Program assistance should be held up until such targets are met with the fallback for the cooperative concerned to a reduced level of LANDBANK own assistance. *Recommendation accepted.*

9. Prepare a program for further former PFI rural bank IB assistance to begin in Q1 of 2006.
Recommendation accepted – to be prepared by UDP local Microfinance TA

ANNEX 3

PROPOSED CHANGES IN MEMORANDUM OF AGREEMENT UPLAND DEVELOPMENT TRUST FUND (UDTF)

BACKGROUND

The UDTF Memorandum of Agreement was finally signed by the four parties, EC Delegation, DA, LANDBANK and UDP on 22 March 2004.

With the agreement of EC and GOP, UDP has been granted an 18 month extension and will now close on 17 July 2007. However with effect from 1 January 2006, the Rural Financial Services (RFS) Component Team is expected to be disbanded with LANDBANK taking over its functions. UDTF progress during the remaining lifetime of UDP will be monitored by the UDP Program Monitoring & Evaluation Division.

PROPOSED CHANGES TO MOA CONTENT

Article B, Implementation Of The Upland Development Trust Fund, Para 7

Interest rates require updating. Proposed new wording:-

The Program funds entrusted to LANDBANK shall generate earnings in two ways: a) Earnings from unused credit and IB fund balances deposited in the UDTF accounts managed by LANDBANK TBG in accordance with UDTF Trust Agreement; and b) Interest charged by LANDBANK on UDTF investment loans to PFIs and other accredited credit conduits at the prevailing LANDBANK rate (currently 12% per annum). Interest earnings generated from use of these funds shall be allocated as follows: (a) 6% to LANDBANK to cover UDTF-related lending costs; (b) 4% for a UDTF Loan Loss Reserve; and c) the balance (currently 2%) for the build up within the UDTF of an IB Fund. Such interest rate and the allocated proportions shall be reviewed by the Steering Committee as required and revised accordingly.

Article B, Implementation Of The Upland Development Trust Fund, Para 10

This is now redundant and should be deleted as it describes the RFS scheme mechanism used prior to MOA Signature which is past history and no longer of use.

Article C. Administration Of UDTF, Para 1

This relates to the controversial ownership issue. In practice DA and EC as Trustors are now jointly responsible for the funds in the Trust Fund. Neither can unilaterally withdraw them as consent of the other party is required under trust banking legislation so that the funds are 'locked-up' and only for mutually agreed use in the UDP-serviced areas.

Proposed new wording to match EC and DA sensitivities and requirements:-

EC through UDP shall remain the legal owner of credit and IB up to the end of the term of the program. On UDP closure on 17 July 2007 the funds shall remain in the UDTF account with DA and EC continuing as joint TRUSTORS until such time that the UDTF funds are exhausted. LANDBANK Trust Banking Group (TBG) is entrusted the administration of UDTF through a Trust Agreement, and LANDBANK Mindanao Branches Group (MBG) shall manage the use of the funds following the principles of sound financial management.

Article C. Administration Of UDTF, Para 2

Details of the LANDBANK TBG bank accounts need inclusion. In addition there is now a need to allow the Steering Committee to transfer funds between the credit and institution-building accounts should future demand require more IB funds which cannot be provided from approved UDP budgets or uptakes of credit fall below original projection. Proposed new wording:-

For this purpose, LANDBANK shall open two (2) sub-accounts within the UDTF which shall be the repository of loan funds including principal collections (Trust Sub-Account A with TA No. 05-058 and SA No. 3401 –0328-85) and capacity-building funds released to the borrowers / beneficiaries (Trust Sub-Account B with TA No. 05-058A and SA No. 3401 0328-93).

To facilitate effective use of all such funds, transfers between Trust Sub-Accounts shall be made subject to the written approval of both DA and EC as Trustors.

Article C, Administration Of UDTF, Para 3

This clause requires GOP and EC to jointly decide six months before the end of UDP on the need for the continued management and use of UDP funds after its closure.

This clause is redundant and should be deleted as the vast majority of UDTF funds currently committed are loans for long gestation crops requiring repayments to continue beyond July 2007.

Article C, Administration Of UDTF, Para 4

EC requested a simplification of this paragraph. Proposed new wording:-

Based on annual external independent assessments, the Trust Fund could be discontinued in cases where serious deficiencies are established.

Article C, Para 5 Administration Of UDTF, Para 5

EC requested a simplification of this paragraph. Proposed new wording:-

LANDBANK shall be responsible for all credit and IB documentation which shall be made available for review and audit by UDP and/or Commission of Audit (COA) and parties authorized by the individual Trustors, DA or the EC.

Article D. Client/Partner Institutions, Para 1

Only eleven UDP PFIs are currently active. The Cooperative Bank of Davao Oriental went bankrupt on 31 October 2004 and should be deleted from the table therein. Proposed new wording:-

LANDBANK shall initially but not exclusively work with the eleven (11) remaining PFIs of UDP.

Article E. Organization & Management, Para 1

Five DA/EC Trust Funds involving a total of at least Php 150 million and servicing the credit & institution-building needs of former DA/EC project areas {UDP (2), CECAP, CASCADE, CATAG} could be in operation by mid 2006 with the same representatives from DA Manila and EC Delegation required to sit as Co-Chairpersons/Members. All Steering Committees are expected to meet at least quarterly.

To introduce a greater element of policy standardization and cost efficiency, UDP have proposed and DA Manila, the EC Delegation, ACPC and PCFC supported the idea that a single national Steering Committee should be established to oversee all DA/EC Trust Funds. If implemented, each Trust Fund would retain its autonomy and its own secretariat arrangements which would work under the coordination of ACPC which will act as the Steering Committee Secretary. ACPC is the DA subsidiary charged with implementing EO138/AFMA. Proposed new wording:-

1. A national Rural Finance Trust Fund Steering Committee (“the Steering Committee”) formed to oversee all Trust Funds originating from EC financing shall supervise UDTF operations. LANDBANK MBG shall manage all UDTF credit and IB operations and report directly to the Steering Committee. The composition of the Steering Committee shall be:

| | |
|---|--------------------|
| EC Representative (Operations Section) | Co-Chairperson |
| DA Representative (Undersecretary Operations) | Co-Chairperson |
| EC Representative (Contracts & Finance Section) | Member |
| DA Representative (Agricultural Credit Policy Council ACPC) Executive Director ACPC | Member & Secretary |
| Upland Development Trust Fund (UDTF) Representative Land Bank of the Philippines (LANDBANK) SVP & Head, Mindanao Branches Group (MBG) | Member |
| Upland Microfinance Trust Fund (UMTF) Representative People’s Credit & Finance Corporation (PCFC) VP Operations | Member |
| Former CECAP & Former CASCADE Trust Funds’ Representative ACPC Director | Member |

2. Co-Chairpersons and Members of the Steering Committee shall nominate alternates to serve as their representatives if required. Trust Fund Representative members shall have voting rights solely for matters relating to their individual Trust Funds. LANDBANK, PCFC and ACPC shall assign support staff to attend Steering Committee meetings as non-voting participants.

3. ACPC shall provide secretarial services to the Steering Committee.

4. LANDBANK, PCFC and ACPC shall operate Secretariats for the individual Trust Funds they administer.

5. The mandate of the Steering Committee is to oversee the operations of all Trust Funds with the LANDBANK TBG and the individual Trust Fund programs themselves. The Steering Committee shall solicit the participation of EC, DA, and the individual Trust Fund administrators in making decisions especially on major policy matters that pertain to interest rates of Government Financial Institutions (GFIs) to partner rural banks, cooperatives and other microfinance institutions, changes in operating guidelines and procedures, and approval of Annual Workplans and Budgets. Decisions in such matters need to be endorsed by the Trustees EC and DA and if need be by the party signing the MOA controlling the specific Trust Fund in question. Any dissenting opinions of any of the aforesaid partners shall constitute no decision. Minor policy matters (e.g. realignment of funds, administrative concerns etc.) shall be resolved by simple majority vote.

Article F. Duties & Responsibilities Of The Different Parties

Given the UDP plan to handover its Rural Financial Service responsibilities completely by January 2006, the following section needs updating: Proposed new wording:-

Article F. Duties & Responsibilities Of The Different Parties, Section 1

1. Until the eventual closure of the UDP Program, UDP shall:

- a) Effect the transfer of Program funds to LANDBANK in accordance with Section B of this Memorandum of Agreement in line with Annual Workplans and Budgets (AWP&Bs) approved by EC & DA as soon as funds have been released by EC. Once the UDP Program is closed, no subsequent transfers can be made.

Article F. Duties & Responsibilities Of The Different Parties, Section 2

2. LANDBANK and PCFC, Para D) Shall Read:

Prepare Annual Workplans & Budgets for Steering Committee approval to ensure finance will be adequate to meet credit demands of PFIs and other accredited conduits as well as the funding requirements for institution building;