Credit Guideline for
Financial Service Centers

I. General Statement

This guideline shall govern the credit operations of Financial Service Centers (FSCs) in all UDP targeted barangays. The policies, procedures and instruments hereof are consistent with the Rural Financial Services System (RFSS) being espoused by UDP.

The overall objective of RFSS is to establish a savings-based credit delivery system in the uplands. Such system will revolve around the Financial Service Center (FSC) --- people-owned and controlled bank-like financial institution capable of providing production and provident loans and savings services at reasonable terms to upland communities.

The upland households shall put up FSC. They are expected to embark on a capital build-up program and other means of generating internal funds to capitalize FSCs. The upland households should also patronize FSCs as trustworthy keeper of funds. As such, FSCs shall have two possible sources of loanable funds i.e., share capital and member-savings. The third possible source of funds is the Seed Capital from UDP. In order not to undermine the self-help orientation of FSCs, UDP shall release the Seed Capital based on the share capital and savings resources that FSCs can generate in due time. The Seed Capital is available up to P 100,000 per FSC.

These guidelines are also premised on certain interim arrangements that are necessary prior to the full blossoming of FSCs. These interim measures basically revolve around the prominent role of partner financial institutions (PFIs) in implementing the credit operations of FSCs. This means that the PFIs may have to run the whole credit operation in the mean time that the FSCs are undergoing capacity-building activities. Under no case, however, shall these interim arrangements be extended after two years.

II. Objectives of FSC Lending Facility

The objectives of the FSC lending facility are the following:

1. To provide accessible savings-based credit facilities at market-oriented rates to the upland households.

2. To support the creation and expansion of economic activities of poor households in the uplands.

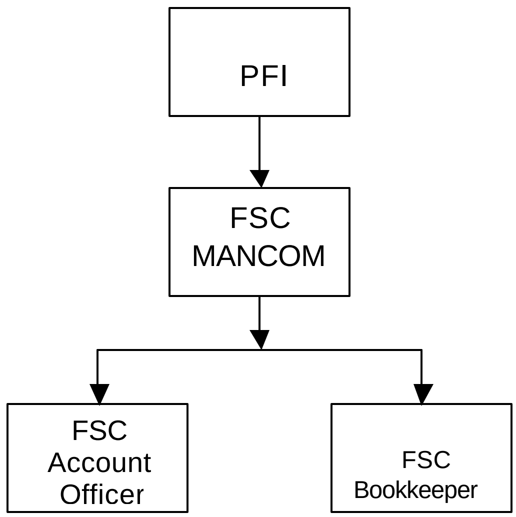
3. To promote entrepreneurship, value-added creation, commodity-production and ultimately project-orientation in the uplands.

4. To advocate environment-friendly or ecologically-sound economic activities among the poor upland households.

III. Organizational Setup

The FSC under an interim arrangement is under the guardianship of PFIs. The PFIs provide two types of services: (a) Financial – acting as the administrator of Seed Capital in behalf of the FSC; (b) Technical – acting as trainor-mentor until such time FSC is able to operate independent of PFI. Figure 1 below illustrates the operation of FSC vis-à-vis PFI.

Figure 1. Organizational Set-up of FSC



Hereunder are the specific roles and responsibilities of various personnel and functional units.

Roles	Responsibilities
PFI as Administrator of Seed Capital	? Receives Seed Capital from UDP and opens an account in the name of the FSC ? Releases Seed Capital based on approved lending terms and conditions ? Maintains good quality portfolio of FSC ? Ensures repayment of Seed Capital and facilitates FSC investment to Upland Development Loan Fund (UDLF)
PFI as Trainor-Mentor	? Convenes FSC Management Committee (MANCOM) with bank representative as Chairperson ? Formulates credit policies in consultation with SLGs ? Conducts strategic planning and budgeting to ensure viability of FSC ? Provides training and advisory services that will strengthen the savings and credit operation of FSCs
FSC MANCOM	? Acts as the policy making body of FSC ? Screens/endorses loan applications of members ? Enforces joint and several liability schemes

FSC Account Officer	? Acts as the full-time Manager/Cashier of FSC ? Directly responsible/accountable to MANCOM for day-to-day operations ? Ensures the prudent management of funds entrusted to FSCs
FSC Bookkeeper	? Records all financial transactions of FSC ? Keeps all records of FSC ? Reports directly to FSC Account Officer for directions

The FSC, whenever appropriate, shall operate with fixed budgets for salaries and wages, operating costs and administrative support. Presented below is an indicative budget of FSC in a year.

Cost Item	**Amount**
1. Honorarium for FSC Account Officers (P 1,200 x 13 months)	P 15,600
2. Honorarium for FSC Bookkeeper (P 300 x 13 months)	3,900
3. Travels, fuels, promotions/representations, etc. (P 200 x 150 days)	30,000
Total	P 49,500

Say, at 28 percent interest rate, the FSC should maintain at least P 176,786 worth of loans to cover costs. Assuming the average loan size id P 3,000, the FSC should lend at least 59 accounts at any given time to break even. This will require a productivity level of 29 accounts or loan volume of P 88,500 per FSC staff.

IV. Policy Guidelines

A. Eligible Clients

Generally, eligible clients include upland farmers with expected secured tenure and are residents of small watershed-based sitios for at least two years. Specifically, the eligible clients are:

1. SLG members who have completed the six (6) months-qualifying period.

2. SLG members who have consistently saved at least 16 times during the first six months.

3. SLG members who have attended at least 16 times of the SLG weekly meetings.

4. SLG members willing to be endorsed and guaranteed by the whole SLG.

5. SLG members who have enlisted co-maker statements from at least four (4) members of the SLG.

6. SLG members who have truthfully shown need for financial assistance based on the loan applications and other evidences.

B. Purpose of Loans

As a matter of principle, loans for upland households should not distinguish between funds for household and funds for productive efforts. The finances of the poor upland households are so simple that they do not borrow for specialized purposes. The preference therefore is to provide them small loans regardless of purpose. They should not be given restrictions on the use of loans in order to give them more space for maneuverability.

However, due to the requirements of Management Information Systems (MIS), it might be practical to monitor topography of loans according to the following categories:

1. Production loans – largely for the procurement of material inputs needed to produce market-driven and ecologically sound agricultural products.

2. Working capital loan – for the expansion of existing microenterprises or off-farm based economic activities, which are considered the main source of sustenance by the would-be clients.

3. Emergency loans – for the purpose of tiding over the whole-life support system of upland households in times of emergencies.

C. Loan Parameters

1. Loan Amount

Poorer borrowers prefer smaller loans. The smaller the loans, the higher the likelihood that the greater number of the bottom poor are served. The guiding principles applicable here are the following:

- Repeat loan concept – borrowing in small amounts repeatedly until such time, depending on repayment performance, build up of trust and confidence and financial impacts of such credits, may go up at bigger amounts. Rule of thumb here is to lend only at loan size that will entail weekly amortization equivalent to an amount not more than twice the average weekly savings posted during the qualifying six months. Say, if savings averaged P 10 per week (during the first six months) then lend only at an amount that will require loan amortization of P 20 per week. Note that this sample is applicable only to loans payable in weekly mode.

  The first loans intended for productive purposes shall not exceed P 3,000 per borrower. Such amount shall gradually increase, based on actual credit needs, up to a maximum of P 12,000 per borrower.

  Loans for emergencies, on the other hand, shall be P 1,000 for the first cycle and P 2,000 for each time thereafter.

- Accompanying capital build-up – the provision of loan shall be accompanied by a pledge to embark on a capital build-up continuously. The share-capital generated will form part of the yardstick for determining loan amounts, in particular, and measuring creditworthiness in the future, in general. It should be emphasized that loan amounts are not determined using the formula lending approach. Meaning, loan amounts are not function of share-capital nor savings.

- Continuing savings – borrowing shall also go with the perpetual savings regimen. The attitude of borrower towards savings plus his/her actual savings are good parameters for evaluating loan applications too. To reiterate, there shall be parity between savings and credit but not within the context of formula lending.

- The other bases for determining loan amounts are the share capital and savings of co-makers. Their combined share-capital and savings will indicate how much each one can borrow and up to the extent they can co-make each other.

2. Interest rates

- Basic interest rate – 3.5 % per month

- Service Charges – 2 % per account

- Interest charges are computed straight and discounted upon release of loans

3. Penalty

The penalty shall be pegged at 2 % straight on every missed amortization/payment.

4. Term of Loan

Generally, loans shall mature minimum of 30 days and maximum of 180 days based on needs and cash flow. Hereunder are indicative amortization schedule based on various terms.

Option A – Straight Weekly

Loan Amount	Three Months Term (13 weeks)	Total Loan Value (28%)	Six Months Term (26 weeks)	Total Loan Value (28%)
P 1,000	P 82	P 1,070	P 44	P 1,140
P 3,000	247	3,210	132	3,420
P 5,000	412	5,350	219	5,700
P 12,000	988	12,840	526	13,680

Option B – Forty-Sixty Repayment (40% weekly – 60% upon maturity)

Loan Amount	Three Months Term (13 weeks)		Total Loan Value (28%)	Six Months Term (26 weeks)		Total Loan Value (28%)
P 1,000	P 33	P 641	P 1,070	P 18	P 672	P 1,140
P 3,000	99	1,923	3,210	53	2,042	3,420
P 5,000	165	3,205	5,350	88	3,412	5,700
P 12,000	395	7,705	12,840	210	8,220	13,680

5. Co-Makers

? Members of SLGs shall form a sub-group or a solidarity group of five members. All members of such group shall simultaneously co-make each other. Preferably, not all the five members of the solidarity group will be allowed to borrow at the same time.

? The whole SLG will endorse the loan applications of individual members. Such endorsement will be accompanied with a guarantee that in case of default and as a last resort, the whole SLG will be made accountable to the loan obligations of all members. In effect, the first line of defense against default is the solidarity group. The next and probably the last line of defense is the guarantee of the whole SLG.

- The amount of loan that each SLG member can avail shall be based on the collective savings and CBU track record of solidarity groups. This implies that any member not in good standing may bring down the credit absorptive capacity of the rest of the members of the solidarity groups. No member of the solidarity groups has an outstanding past due account.

6. Loan Repayment

One need not wait for the harvest in order for a borrower to repay. The underlying assumption here is that a typical upland household has more than one source of income to be able to cope or survive. The upland farmers have discernable cropping mix that revolves around the main crops like corn, banana, abaca, coffee, etc. They have peanut, mongo, etc. on the side. Not to mention the pig fatteners, daily egg production, occasional sale of chicken, etc. as additional supplements. All these various income sources point to the fact that a typical upland household has distinct cash flow pattern that will allow small payments at shorter and more frequent intervals. Meaning, weekly amortization is likely possible to an upland farmer who borrowed for say, corn production with a gestation cycle of 4-5 months.

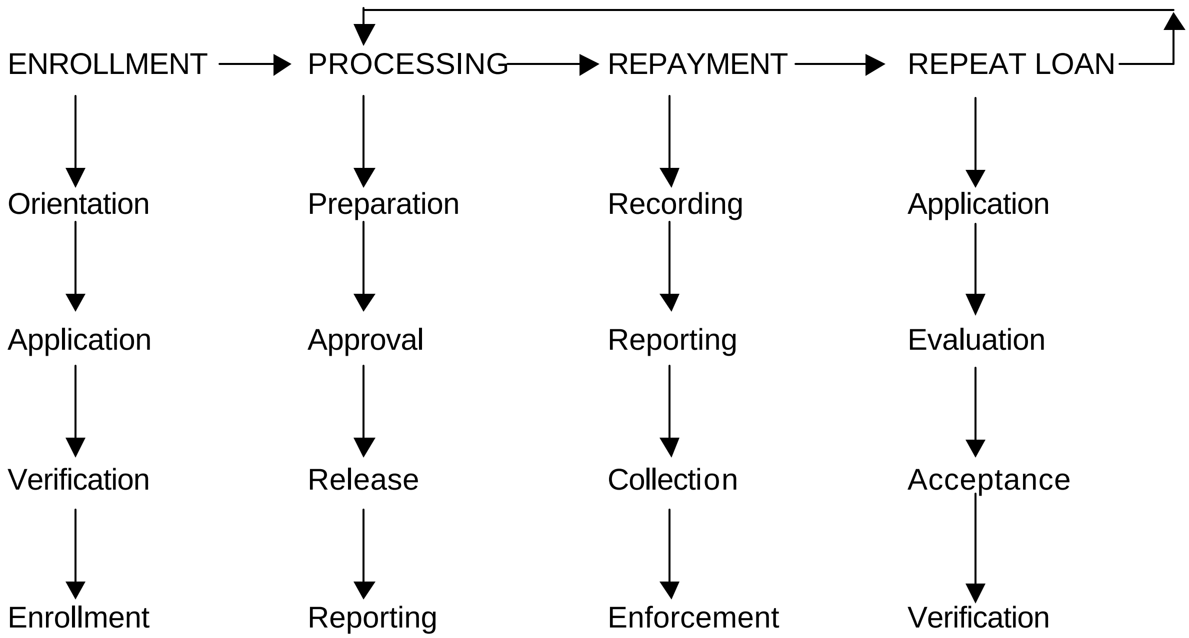
The preference accorded to weekly or any other shorter repayments is consistent with the best practices of microfinance practitioners all over the world. That to ensure 100% repayment, lend only in small amounts and collect at shorter intervals, e.g., daily, weekly, etc. Presented below are some of the possible schemes wherein shorter repayments are enforced:

- Considering the long gestation cycles associated with the various enterprises in the uplands, weekly amortization is deemed most appropriate. To lighten the load, weekly amortization can be combined with balloon payments. Say, half of the loan amount can be amortized weekly and the other half paid lump sum after harvest time. What ever the scheme, the bottomline is small, regular amortization at shorter intervals.

- To inculcate the habit of paying at shorter intervals, weekly payments can be passed on as savings or capital build-up. Meaning, a borrower may be asked to enter into an agreement (upon release of loan) that will require him/her to put up small amounts at regular and shorter interval, which will be labeled as savings or share capital. These savings or share capital will be deposited in a special account and will only be drawn if the loan becomes sour.

V. Implementation Procedures

Presented below is the general flow of activities that shall be implemented in implementing the FSC credit facilities.



1. Procedures for Enrollment to FSC Credit Facilities

The purpose of enrolling clients to FSC is to generate the long list of potential clients. The FSC should be able to sort out and filter individuals who could be target for promotions and inclusion in the FSC credit facilities. The act of enrolling potential clients will further validate information (gathered through PRA) on family income, family size, livelihood, level of skills and capabilities, options, opportunities, savings potential, credit reliability, degree of indebtedness, and income-loss vulnerability.

The main instrument for enrollment is conduct of orientation activities. Such orientation dwells on the objectives, requirements for application, terms and conditions of different loan products, and other information that clients should know within the context of transparency. All interested to borrow are required to attend the orientation.

The UDLF FO shall conduct the orientations in the local community at least once every two weeks provided there is enough number of attendees.

Listed below are some materials that have to be distributed to the attendees before the start of the orientation:

- Brochures on FSC, its missions, credit facilities, etc.

- Guidelines on Organizing Solidarity (Savings and Loan) Groups

- RFSS materials (as developed by PFIs)
- UDP reading materials on RFS

In addition to the above-mentioned materials, the UDLF FO should show the different forms that they need to submit. The forms include the following:

- PRA form (questionnaire administered by UDLF FO)
- SLG information sheet
- MOA between and among FSC
- MOA between FSC and PFI
- Application form

The orientation should give emphasis on the guidelines for organizing solidarity groups. This will explain why every member of the solidarity group needs to sign in the promissory note in accordance with joint and several liability arrangements. The solidarity groups should be formed according to the following guidelines:

? The SLGs should be further divided into sub-groups of five members.

? The sub-groups will act as solidarity groups.

? All members of the group should sign in the promissory note of any member borrowing from FSC.

? The members of the group should have endorsement from SLG Coordinator. This puts the whole SLG also accountable to credit obligation of any borrowing member.

In the orientation proper, emphasize the following principles governing credit operation:

? The Small loans first; repeat loans based on successful cycles of repayment

? Short term loans - a priority

? Repayments based on cash flow pattern of household

? Zero tolerance against default

? Credit through joint/several liability scheme

Discuss too the features of savings products, to wit:

? Pledged savings - a form of fixed or forced savings generated through RSMT, which are not withdrawable during the first six months. This kind of savings is sometimes converted into share capital of member-savers.

? Voluntary withdrawable savings - regular deposits recorded as SLG savings deposited with PFI

? Individual savings - regular deposits of SLG members in addition to his/her savings with SLG

Loan applications should be formally received when the borrower attends the orientation. All loan applications should have been reviewed and endorsed by the SLG Coordinator before the loan applicant attends the orientation.

After filing loan application comes loan verification. All loan application documents should be thoroughly reviewed in the office before field verification is conducted. All field verification, on the other hand, should be conducted right in the sitio of the loan applicants. Inquiry on the character constitutes the single-most important item for verification. Character indicators include:

? General standing among SLG members

? Perceptions of friends, neighbors and acquaintances within the community

? Personal vices like drinking, gambling, and the like.

? Family history background

? Kinship among SLG members, if any.

Character must also be reconciled with ability and willingness to honor obligations. His/her compliance with savings pledges during the first six months must be a good proof of credit worthiness.

All information generated in field verification should be contained in a formal report. Such report is treated confidential. Reports should be ready within seven working days after loan applications have been formally received.

Favorable results of verification must lead to formal acceptance or enrollment of the loan applicant into the FSC credit facilities.

2. Procedure for Loan Processing

There are four major steps in processing loans: (a) Loan Preparation; (b) Loan Approval; (c) Loan Release; and (d) Loan Reporting.

? Loan preparation shall essentially preparation of the following loan documents:

- Cashier’s Check with voucher
- Discount statement
- Loan application
- Disclosure statement (full details of loan terms and conditions)
- Credit life insurance application

- Promissory notes
- Borrower information sheet
- Verification reports
- SLG information sheet

All the above documents must be properly and completely filled-up in accordance with the number of copies required. The documents must be free of erasures and errors.

? Loan approval, in the interim period, shall done by the Manager. He should review thoroughly the loan documents and ensure that there is a sufficient fund for the loan. After which shall the Notice of Loan Release to the borrower will be issued.

? The release of loan shall be in a special deposit account of the borrower to facilitate drawdowns only when needed. Meaning, withdrawals shall be made on a staggered basis and consistent with the gestation schedules of the project or activity being financed.

? Lastly, the loan reporting is just to report all loan releases made during the day. It should be accompanied by the usual loan documents (e.g., promissory note) plus amortization schedules.

3. Procedure for Repayment Monitoring

The monitoring of repayment shall also entail four major steps:

Step 1 – Recording

The UDLF Field Officer shall keep records of SLG, name of every member, home address, name and type of project, amount of loan released, mode of payment, date of maturity of loan, amount of regular amortization, etc.

Step 2 – Reporting

Every end of the month, reports on repayment status of loans by individual, by SLG, by type of project shall be generated.

Every 15 days there shall be reports on past due status, list of past due borrowers being considered for litigation and restructured loans, if any.

Step 3 – Collections

The tandem of SLG Coordinator and UDLF Field Officer shall pursue intensive collection efforts. They should have daily collection record to keep tract of loan accounts. There shall be daily list of borrowers scheduled for collection. Such list shall contain information on the following:

- Name of borrower
- Home address of the borrower
- Amount of collectible from the borrower

- Remarks and signature of each borrower who made partial payment of amortization due or borrowers who did not pay.

The daily collection report should be signed by Manager. All daily collection reports shall be summarized into another report containing the following information:

- Date of entry
- Name of borrower
- Total amount for collection
- Total amount collected
- Remarks regarding inability to collect

Step 4 – Enforcement

The UDLF Field Officers shall be responsible in enforcing collections of past due accounts by sending series of notices, demand letters, and (if need be) subpoenas. These measures shall be done until such time the past accounts shall have been fully collected.

4. Procedure for Re-loan Application

The borrower with no past due may re-apply for another loan. Applications shall be filed first with the SLG Coordinator containing the following data:

- Who is applying
- How much loans?
- Purpose of the loan
- Mode of payment
- Maturity of loan

Then, favorable assessment of loan application shall depend on the track record of all SLG members showing no one with past due account. No re-loan shall be approved if there is any member with current outstanding loan.

Usual filing procedures and verification apply for re-loan.

5. Flow of Funds from UDP to PFI to FSC

UDP funds shall be referred to as Seed Capital. It will be released to PFI. In turn, the PFI shall open a liability account in the name of FSC. The Seed Capital is for the exclusive use of FSC to address the some of the financial needs of upland households in the barangay.

VI. Savings Mobilization

No loans shall be sanctioned with due regard of savings. The role of savings in the uplands is to initiate exchange of information and to start the financial relationship between the PFI and the FSC/SLG. Linking savings with credit shall also be a measure to address the lack of collateral in the uplands. The savings-based credit shall encourage the upland households to internally build-up funds for the purpose of partially collateralizing credits. The PFIs (in the future) are not being forced to extend credits mechanically. Credit should be an outcome of dialogue and resulting confidence. The lack of it necessitates the use of collateral. The collateral then is tapped to supplement the lack of adequate confidence. It is in this light that savings assume importance.

The promotion of savings is premised on the following:

?The upland households have equal demand for savings facilities as credit.

?Savings-based credit increases recovery rates. A good saver is likely a low credit risk.

?Savings initiate the build up of internal capital base among upland households.

?Savings-induced capital build-up further reduces credit risks in the uplands.

?Savings without credit may not be sustainable.

VII. Capital Build-Up

The life support system of FSC is the capital base. Internally generated resources constitute the most stable source of loanable funds of FSC.

But for a financial intermediary like FSC, capital assumes a different role:

?Capital exists to provide a buffer to absorb losses and allow a financial intermediary to remain in operation during the period when problems are being corrected.

?To a financial intermediary, the need for capital is to be able to absorb the risk of loss in the value of loans and investments on the books of the institution.

The provision of credit shall similarly be share-capital based. Meaning, credits shall be extended as a proportion of share capital. The more capital shall mean more leverage for bigger credits.

VIII. Phase-out of Seed Capital

The Fund shall remain the property of UDP for the entire duration of the Agreement and any outstanding balance of the Fund net of total amount loaned out and approved for funding under the Fund maybe withdrawn by UDP anytime given (30) days prior notice.

Two years before termination of UDP, the European Community (EC) and Department of Agriculture will jointly decide the ownership of Fund based on concrete proposals to be prepared by UDP staff.

It is possible to hand over the UDP's Fund to the target group as shares, so that they will have a larger share capital within the UDLF to ensure future access to the UDLF. The modalities for this matter will have to be defined later. It is important, therefore, that the FSCs must be involved and participate actively in the UDLF as soon as they acquire shares. Capacity building within this context will be done.