Rural Financial Services System

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Glossary of Abbreviations

FSC	-	Financial Services Centre
GWP	-	Global Workplan
LGU	-	Local Government Unit
NGO	-	Non-Government Organisation
PFI	-	Partner Financial Institution
PMO	-	Project Management Office
PPO	-	Provincial Project Office
RFSS	-	Rural Financial Services System
SLG	-	Savings and Loan Group
TWG	-	Technical Working Group
UDLF	-	Upland Development Loan Fund
UDP	-	Upland Development Programme in Southern Mindanao
USC	-	UDLF Steering Committee

1. Summary of the Proposed Strategy

The overall objective of this component is to establish a savings-based credit delivery system providing production and providential loans and savings services on reasonable terms to upland farmers, enterprises and communities through the establishment of (multi-) municipal level and community level loand funds.

To be able to achieve this objective, the Programme will work through various Partner Financial Institutions (PFIs) in establishing a sustainable financial system in order to provide the needed financial services to the upland communities. The PFIs will be directly responsible in providing the financial services to the beneficiaries and the Financial Services Centres. The Programme as such will not be directly involved.

To improve the existing financial landscape, the system designed will consist of two (2) levels of loan services:

1. A revolving loan fund at (multi-)municipal level to be managed by the Partner Financial Institution
2. A revolving loan fund at community level to be managed by the target beneficiaries when the necessary capacity has been build up with support from the PFI

To encourage financial institutions to lend to upland farmers without the traditional collateral conditions and to accept alternative forms of security, the Programme will forge a partnership with these institutions not in the form of a loan or time deposit, but as equity in the PFIs lending business. This will be formalised by establishing an Upland Development Loan Fund (UDLF) which will also require the provincial governments and the beneficiaries to invest in the fund. The Programme, the PFIs, the LGUs and beneficiaries will equitably share in the profit or losses of UDLF. A Memorandum of Agreement will be established with each PFI willing to implement the scheme.

At community or sitio level, Savings and Loan Groups (SLGs) will be organised to act as guarantee group and as these SLGs develop, Financial Services Centers (FSCs) consisting of SLGs will be formed at strategic locations in the barangay to manage savings and loans services of its members.

This Rural Financial Services System is expected to bring closer to the target beneficiaries the needed financial services leading to increased savings and improvement of access to savings, loan services and insurances for upland communities.

2. Rationale

In the upland areas, very few financial services can be encountered. The only financial services to be found are the following[1]:

[1]A report on this subject has been prepared in UDP: "Assessment of Upland Financial Services", October 1999

1. Production and consumption credit by the traders in the barangay centre. This varies substantially from region to region.
   In most areas both consumption and production credit is given to the upland sitios, and as a consequence, people are very heavily indebted. In certain areas[2], the upland sitios are discriminated and credit is given to only a few of them. Often consumption credit is only given during harvest time, and the amounts are very limited. In these areas access to informal money lenders is very limited.
2. Access to credit by mortgaging of land, fruit trees and harvests.
3. Mutual insurance for death. This is a traditional system, called "dayong". People in a sitio contribute money and food in case of death. Not all inhabitants of a sitio participate.
4. Savings for fiestas, called "sosyo". This is often a once per year deposit for the fiesta in a fund. The fund can be used to borrow from at high interest rates(10% per month). The fund will be distributed amongst the members just before the fiesta.

Other informal savings and credit associations are very rare to be found in the upland areas. Especially amongst the tribal people one will not find these systems.

Access to formal financial institutions, whether banks or cooperatives, is very limited and rare in the upland sitios. The Programme did come across very few banks with services in the upland barangays centres but almost none at sitios. Sometimes there are cooperatives operational in upland barangays, mostly catering for the people from the barrio (central place in barangay). Moreover, their financial services, if any, are limited.

Savings as such do not often occur in the upland sitios. On the contrary, most people are depending on 'cash advances' from local traders to survive till the next harvest. Surplus cash is limited and most cash income is spent immediately. Sometimes surplus cash is invested in non-perishable goods or in agriculture, sometimes just being kept in the wallet by the woman of the household.

As a result of the above, very few investments can be made in the farms. Most people complain about the lack of (access to) finance for increasing the fertility of the land and for other inputs. Consequently, the yields of the harvests are low. On the other hand, harvests of for example corn (most upland farmers do plant corn) are not very reliable and might lead to more debts instead of a higher income.
Another important complain by people is in relation to emergency cases. Almost nobody has money to deal with emergency cases. Often this is the reason why people sell or mortgage their land or crops, and hence reducing their possibility to earn.

The end result of the above described situation is that upland farmers are to be found in a difficult situation. Income is too low. Most of them are indebted heavily. People are struggling to meet their basic needs, and no resource is available to improve the current situation.

[2] We know about Maragusan municipality, but there might be more cases.

Financial institutions remain very hesitant about expanding their services in the uplands. A growing number of them have started to experiment with microlending in the lowlands, and especially in the urban centres. These experiments have been successful and the institutions are looking for ways to expand. However, the problems in agriculture in the last few years (because of el niño) and the financial institutions' lack of knowledge of the upland communities, together with limited funds and staff, do not encourage financial institutions to start to expand towards the upland areas. For this reason, a rural finance component is necessary in the interim, to develop and help establish a viable financial system through which financial services to the upland farming households can be sustained after the Programme has terminated.

3. Objectives

The overall objective of the Rural Financial Services component is:

To establish a savings-based credit delivery system providing production and providential loans, savings services and insurances on reasonable terms to upland farmers, enterprises and communities through the establishment of (multi-)municipal-level and community-level loan funds.

The specific objectives of the Rural Financial Services component are as follows:

1. To build a viable financial system through which financial services to upland farming households can be sustained after the Programme has terminated. This financial system will be administered by a financial institution and, together with other shareholders, owned by the community.

2. To provide financial services to the upland farming households that will enable them to meet their financial demands, to manage their cash flow and to deal with emergency cases.

3. To support the development and expansion of small scale farms and enterprises in the upland areas with an appropriate savings and credit system that will allow upland farmers and entrepreneurs to invest in market-led production systems that will contribute to sustainable production and community based resource management in the uplands.

4. To provide financial assistance to producer trading organisations.

4. Beneficiaries

Several groups of beneficiaries will be distinguished:

1. The farmers in the upland areas, living in the watersheds selected by the Programme.
2. The Partner Financial Institutions that will implement the Rural Financial Services System.

3. Other people in the UDP selected barangays who are not living in the selected watersheds but who have set up their own Savings and Loan Groups. They can adhere to the Financial Services Centre and the Upland Development Loan Fund, if they obey with the rules and regulations of the FSC and the UDLF.

5. Basic Guiding Principles

5.1. Working through Partner Financial Institutions

The UDP will work through various Partner Financial Institutions in order to provide financial services to the beneficiaries and to establish a sustainable financial system. The Partner Financial Institutions will provide the financial services in the upland areas, and the UDP as such will not be directly involved. This will eliminate the dole out mentality developed through the years. Farmers have been used to government credit assistance allowing very poor repayment or lack of effort to collect the loans by government agencies concerned.

At this moment almost no financial institution is providing services in the upland barangays where UDP will be working. Therefore one of the objectives of the Rural Financial Services component will be to assist and support the PFIs to extend their services to the upland barangays. It will include the development of suitable approaches and methodologies to suit the specific situation of the clientele in the upland and the capacity of the PFI itself.

It is expected that by reaching the above mentioned objective, the PFI, with assistance of UDP, will extend and improve the existing financial landscape. The PFI will be encouraged, with the experience gained in UDP, to extend their services to sitios and barangays that are not covered by UDP.

5.2. Provision of Financial Services

Several financial services will be provided, notably savings, credit and insurances. Meeting the demand and the need of the target group, whilst being sustainable at the same time, is the basic guideline for the development of the various products.

Savings will be encouraged from the very start of the Programme.

The provision of credit will depend (amongst others) on the savings behaviour of the person, but in consolidation with the PFIs no direct link will be pursued between the amount of savings and the loan amount.

The first loans at sitio level will be relatively small, short term and managed by the FSC established by the PFI as soon as it is capable to take up this function.
Larger loans, medium and long term loans and loans for big projects will be managed solely by the Partner Financial Institution.
The ultimate approval of the loan application will be made at the level where the loans are managed, by the FSC Management Committee at community level and by the PFI at UDLF level.

5.3. *Access to financial services*

Access to the financial services will be organised at sitio and barangay level. Group savings and group loan repayments will be done at sitio level.
It has been noticed that most upland farmers do not travel further than the centre where they can sell their products. This is in most cases within the same barangay, sometimes in an adjacent one.
This is the place where the access to financial services will be organised. Individual savings and loan repayments, withdrawal and loan disbursements, as well as access to bigger loans at PFI level, will therefore preferably be done in this trading centre.

Access to financial services should be organised at least on a weekly basis, as most upland farmers have regular cash flows.

5.4. *People's participation in the ownership, control and management of the financial system*

The proposed financial system will be built primarily upon the groups that will be formed (Savings and Loan Groups [SLGs] and Financial Services Centres [FSCs]) and the savings that will be generated by the people within the target communities. Its effectiveness will, to a large extent, depend on the people's commitment to nurture the growth and development of the system. The depth of the people's commitment, however, will depend on the extent of their participation in the ownership, control and management of the system. To generate genuine commitment, therefore, the Programme will:

(i) promote regular and continuous building up of capital to enable the upland farmers to increase their equity in the system;
(ii) provide opportunities for the representatives of the upland farmers to participate in credit policy-formulation and decision making at the Programme level; and
(iii) where capacity is existing prepare the community-based organisation to take over the management of the community-based revolving loan funds.

5.5. *Partnership financing and equitable sharing of credit risks*

The credit risks faced by financial institutions when lending for the first time to inexperienced upland farmers could be considerably high and very few financial institutions, if any, would be willing to take on these risks without sufficient loan security cover. To encourage financial institutions to lend to upland farmers without traditional loan collateral requirement and to accept alternative forms of security, the Programme will forge a partnership with these financial institutions, not in the form of a loan or time deposit, but as equity in the banks' upland lending business. As the bank's partner in lending to upland farmers groups, the Programme will equitably share in the profit or losses of the loan fund. This arrangement will be detailed in a Memorandum of Agreement with each of the PFIs and agreed Implementation Guidelines with the PFIs.

5.6. Cost-covering financial charges

The Programme will require financial institutions and upland farmers' groups to charge loan interest rates that will cover their respective borrowing and operating costs. No interest rate subsidies will be involved at any stage of the lending chain.

5.7. Gender issues

It is regarded amongst the upland farmers that men are the ones doing the largest part of the agriculture. Women "help"; especially with weeding, but also with planting and harvesting. It is mostly women who do the subsistance farming of vegetables and root crops and who keep the smaller livestock.

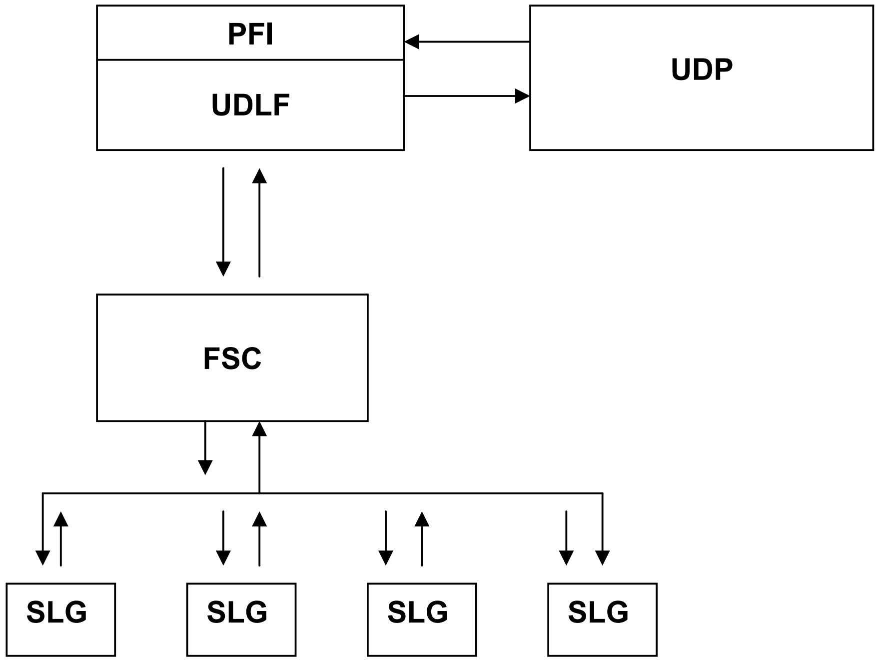
Women are the financial managers in the households of the upland farmers. They are the ones controlling the budget and guarding the funds. The women will give some money to the husbands as pocket money, which might be as high as 30% of the household budget. Women ususally do not have access to pocket money.
According to Philippine law, both husband and wife are responsible for the repayment of a debt that one of them has undertaken.

In order to assure that both husband and wife will take care of the financial situation and the repayment of a loan, both should be informed and should sign the promissory note for a loan.
As it is the objective that both husband and wife will benefit by participating in the UDP, it will be encouraged that both will participate in Savings and Loan Groups. The membership of groups hence will not be limited to one member per household, but to either husband or wife or both. This is in compliance with the new government policies with regard to promoting gender equality.

As women are traditionally the financial managers of the household, it will be encouraged that women especially will be engaged in the management of SLGs and FSCs.

6. Organisational Structures

At different levels, different types of organisational structures will be set up.



At community level, Savings and Loan Groups (SLGs) and Financial Services Centres (FSCs) will be set up. SLGs will be formed at sitio level and will act as loan guarantee groups. The SLGs will adhere to an FSC in their area. This FSC will manage savings and loans at community level as soon as they have build up this capacity with support of the PFI.

At the level of the Partner Financial Institution (PFI), covering one or more municipalities, an Upland Development Loan Fund (UDLF) will be established that will be managed by the PFI. This UDLF will take care of bigger loan needs by the FSC members that cannot be met by the FSC itself.

Here below the various organisational structures are discussed in more detail.

6.1. Savings and Loan Groups (SLGs)

People will be encouraged to form themselves into savings and loan groups (SLGs) at watershed level. There may be more than 1 SLG per sitio or watershed. Where the number of households in one sitio is very limited, an SLG may cover several sitios. The number of members in an SLG can vary between 5 and 25 members. Preference is given to 10-15 members per group, as in most areas not much experience and capacity is existing at SLG level in organising groups and group finance.

Meetings will commence on a weekly basis. This frequency can be reduced later when groups have become coherent and the members have gained knowledge and experience within the SLG.

It is important to bear in mind that the members of the groups have to select themselves, as they will have to guarantee each other. Forced grouping may create problems as some of the members may not trust some other members.

Qualifying period
It is anticipated that the formation of savings and loan groups will be one of the first activities to be undertaken in the upland areas after the general community development process has started and the umbrella organisation within the community has been formed.

Anyone interested to become a member will be required to go through a six months qualifying period. The conditions to comply with during this period will depend on the policy of the implementing Partner Financial Institution. It is assumed that it will include training, attendancy of group meetings and savings.

The Programme can make use of this period by introducing and encouraging members to start and adopt new technologies and other crops with a better market potential, which will include the Programme-selected environmentally sound farming systems.

Existing saving and loan groups, as well as old-SMAP groups in the areas where the SMAP has been working, are allowed to form themselves into SLGs and adhere to the FSC. They have to undergo the 6 month qualifying period as well before being accepted and to be allowed to apply for loans.

Activities
The SLGs, which will be headed by a Coordinator and a Treasurer, will do the initial screening and evaluation of loan applications for endorsement to the FSC Management Committee, collect savings and/or repayments and monitor the utilization of loan proceeds and implementation of financed projects by the SLGs members. The SLG will act as a mutual guarantee group in which a loan to a group member automatically becomes the obligation of the entire group.

If the members of a savings and loan group decide to apply for loans, it is recommended that they will design their own group guarantee fund to insure against default due to unforeseen circumstances. Insurance that might be organised by PFIs in some of the areas will be able to cover default due to death.

6.2. Financial Services Centres (FSCs)

Financial Services Centres will be established in a trade centre which may be in a barangay centre or a sitio, and will cluster sitios or some barangays. The most important criteria for the selection of the coverage is that the establishment will be situated in a trade centre, where UDP beneficiaries will come to sell and buy and that the potential clientele is large enough to ensure the sustainability of the FSC. For planning and budgetting purposes it is calculated that there will be at average one FSC organised in each barangay, as is the impression gathered during field work for the preparation of the GWP. This means that in total 120 FSCs will be organised.

Only savings and loan groups can adhere to an FSC. Members of SLGs can apply for loans from the UDLF (even if not residing in the UDP watersheds). Individuals who aren't members of an SLG cannot become members of an FSC, nor can have access to funds from the UDLF.

PFI Support

Once per week the Field Officer of the Partner Financial Institution (the so-called UDLF Field Officer) will spend (part of) one day at the centre to collect savings and repayments, to disburse loans and to pay savings withdrawals. This time will also be used by the officer to monitor the performances of the groups, to train and to advise on any matters related to the financial system.
The UDLF staff (Field Officer and/or Account Manager) will need to spend more than one day per week in one barangay during the first year of the existance of SLGs and FSCs in that barangay, for group formation, training and guidance. After this first year less time will be needed in this respect.

Seed Capital

Each FSC will have its own savings account with the PFI.
The FSC can apply for seed capital from the Programme to capitalise its revolving loan fund after being operational for at least six months. The decision whether to honour the application depends on the performance of the FSC.

The community's savings plus the seed capital will be used to establish a revolving loan fund. This revolving loan fund will be managed by the FSC and will be used to finance the credit requirements of small, individually-operated, farm and non-farm micro-businesses.

The seed capital provided by the Programme has to be returned. It will be paid into the Upland Development Loan Fund and will be seen as the shares of the FSC in the UDLF, instead of those of the Programme (see Chapter 11 for more details).

FSC Management Committee

Each FSC will be administered by a Management Committee to be composed of five members. The committee will be represented by four representatives - one representative from each of the four biggest SLG investors from the UDP target sitios in the FSC. The remaining member is the representatives of the PFI (UDLF Field Officer). The said representative of the PFI will sit in the Management Committee as afully-participating member until such time when the community will have fully returned the seed capital invested by the Programme. A UDP representative (the Support Officer) will participate in the meetings as an ex-officio member.

Upon the full returnment of the seed capital invested by the Programme, all five Committee members will be composed entirely of the representatives of the biggest SLG investors. At least three of these investors will be from the upland sitios[3], the other two representatives can also come from other areas in the barangay, as it is assumed that by that time the PFI will have expanded its financial services to other areas within the barangay. The majority of the Committee members have to be from

[3]Which upland sitios exactly will be decided separately in each barangay.

the upland sitios, in order to assure that in the future the people from the upland sitios, will continue to benefit from the financial services offered by the FSC.

The FSC Management Committee will be chaired initially by the PFI representative. The chairmanship will be turned over to one of the four representatives of the upland sitios when 50 percent of the seed capital provided by the Programme shall have been returned by the FSC.

The FSC Management Committee will be responsible for the approval of membership applications and individual loan applications not exceeding P 12,000 and not exceeding a one year repayment period. For loans above P 12,000 or for longer than 12 months, the FSC Management Committee will review and recommend appropriate action on these loan applications to the PFIs. The FSC Management Committee will meet regularly to review and approve membership and loan applications, discuss and resolve problems, and review and plan the operations of the FSC.

Support to the FSC
The FSC might want to hire a professional staff to run the centre. The Programme will subsidize the salary of the Accounts Officer at FSC level during a four year period. The conditions for this support by the Programme are to have at least 100 members and to operate satisfactorily for at least one year as Financial Services Centre. These conditions will be finalised in the second year of the Programme.

Each FSC will be entitled to a subsidy spread over 4 years for the employment of an Accounts Officer. After this period, the centre should be able to bear the expenses of an Accounts Officer by itself.
If an FSC has 200 members or more and has operated satisfactorily for at least two years, it can apply for a loan from the UDLF for the acquisition or construction of a modest office structure, and the acquisition of basic office furniture and equipment.

6.3. Partner Financial Institutions (PFIs)

Partner Financial Institutions will be selected in each province to be the lenders and the financial advisors to the SLGs and the FSCs. They will be the custodians of the Programme's credit funds in the UDLF.
Although in the original proposal for the Rural Finance component it is stated that there will be a total of 8 PFIs, it has been found that the total number of PFIs will be bigger, due to the low capacity and coverage of each PFI[4]. It is estimated that a total of 14 PFIs will be necessary to cover all the municipalities of the five provinces, although a thorough assessment still has to be made of the possible PFIs.

A suitable Partner Financial Institution can be a Rural Bank, a Cooperative Bank, a cooperative or an NGO that is providing financial services. The selection criteria for PFIs include:

- capacity and willingness to work in the upland areas and to implement the rural financial services scheme

[4]One cannot find financial institutions that are covering all the UDP municipalities in one province. It is estimated that the management capacity of most financial institutions visited is not big enough to allow a substantial increase in coverage. As a result, the total number of PFIs should be increased to allow the UDP to cover all municipalities.

- financial stability
- management capacity to grow

Preference will be given to those PFIs:

- with experience in micro-lending
- showing initiatives to reach upland communities
- already covering the municipalities
- being able to cover several municipalities

<u>Subsidy for UDLF staff</u>
Each PFI will be asked to provide staff for the management of the UDLF and the establishment of the UDP Rural Financial Services programme in the selected barangays.
The Programme will subsidize, on a gradually diminishing basis over a three-year period, the salaries of this UDLF staff for each of the PFIs. The subsidy will be 100% in the first year for the time that they are working within the UDLF[5]. The subsidy will be subsequently reduced to 70 percent of their salaries in year 2 and to 30 percent in year 3. On the fourth year, the PFIs will be made to assume the full cost of the staff's salaries.
These arrangements will be the subject of a Memorandum of Agreement to be signed by the Programme and individual PFIs.

The UDLF staff will be hired and supervised by the PFI. Although officially PFI staff will be working in close liaison with the Rural Finance Officer at the PPO and the Support Officer at municipal level.

<u>UDLF Field Officer</u>
It is estimated that one Field Officer can handle up to 6 barangays. If the UDP will work in more than 6 barangays, more Field Officers may be needed. However, the capacity of the PFI to handle a great number of barangays have to be taken into consideration when deciding to extent financial services to a much bigger number than 6 barangays.

The UDLF Field Officer will be responsible to:

1. organise the SLGs and the FSCs, together with the UDP Provincial Rural Finance Officer.
2. help the FSCs evaluate individual loan applications.
3. train and supervise the FSC Account Officers.
4. oversee the conduct of the FSC regular membership meetings.
5. monitor the micro-businesses financed by the FSCs.
6. facilitate the disbursement of the PFIs' loans to, and collection of savings deposits and repayment of loans from, the FSCs.

<u>Account Manager</u>
PFIs covering three municipalities or more can receive subsidy for a full-time Account Manager for the UDLF. PFIs covering only one or two municipalities can have subsidy for an Account Manager on a part-time basis. The exact percentages will

have to be established during the discussion on the Memorandum of Agreement between the UDP and the PFI.

The UDLF Account Manager will be responsible for:

1. installing the financial system among the FSCs
2. auditing the books of the FSCs
3. preparing the monthly financial statements of the FSCs.
4. training and supervising the FSC Account Officers on the recording and reporting of their savings and credit transactions.
5. maintaining separate books of accounts for UDLF in the PFI.
6. preparing a monthly report of UDLF transactions and status of funds.

The Programme will provide training to the PFI staff who are linked to the Programme. The training will cover various aspects of working with upland barangays, savings and credit management and the management of the UDLF.

The Programme will provide one motorcycle to each UDLF field officer and each UDLF account manager for the exclusive use of the UDLF staff working within the UDP. The PFIs will be made to assume the fuel and maintenance cost of the motorcycles.

The PFIs will be encouraged to expand their services to people outside the UDP. Since the UDP wants to build a viable financial services programme that is sustainable after the Programme has terminated, it is obligatory that the PFI will build a strong and solid base in each barangay. It cannot be expected that a financial institution will limit itself only to the few sitios where UDP will work, as this never can be viable.

Replicability

It is believed that PFIs will be able to expand its services to other barangays where UDP is not involved, once it has experienced that delivery of financial services at barangay level can be profitable for an PFI. Replication of the UDP model by the PFI will have to be done with the PFI's own resources and staff.

PFIs will be encouraged to invest more capital than the obligatory amount in the UDLF that can be used for FSCs that are not part of the Upland Development Programme.

6.4. Upland Development Loan Fund (UDLF)

An UDLF will be established with each of the PFIs and will be made up of the following fund contributions:

I. the credit fund of the Programme for the area (three times the amount given as seed capital to the FSCs in the area - see chapter 11, page 19)
II. the repayment of the seed capital by the FSCs
III. the contribution of the PFI, an amount up to P 750.000 per municipality
IV. the contribution of the provincial LGU, which will vary accordingly to number of municipalities covered.

The PFI will be the custodian of the Programme credit funds deposited in the UDLF. The PFI as custodian will make sure that the credit funds are lent and invested prudently according to the policies approved by the UDLF Steering Committee, the policy-making body of the UDLF. The PFI will approve the loans to be lent from the UDLF.

Beneficiaries shareholding

The portion of the seed capital returned to the UDLF shall be recorded as the FSC's shareholding in the UDLF. This shareholding will entitle the FSCs to participate, through their representatives, in the management of the Fund, share in any income that will be generated (or losses that will be incurred) by the fund, and augment their own capital by borrowing from the Fund. Only FSCs that own shares in the UDLF will be eligible to borrow from the Fund. An FSC can begin to borrow from the Fund when it shall have returned 50% of the seed capital invested by the Programme.

FSCs will be encouraged to invest more capital in the UDLF, in order to increase their share and decision power and to increase their access to funds.

Income earned

Income earned by the UDLF from its lending operations (after deduction of a management charge agreed upon between PFI and UDP through approved Annual Workplan) will be divided amongst the UDLF partners (Programme, beneciaries, PFI, LGU) in proportion to their shareholding/capital investment. The institutional owners of the UDLF will have to agree on the nature and amount of the operating expenses. The income due to the Programme represents its return on the investment in the UDLF. The income due to the Programme will be accredited to the Programme but will remain within the UDLF.

End of Programme

At the end of the Programme, the European Commission and the Department of Agriculture will decide on the destination of the Programme's capital within the UDLFs, based upon a detailed proposal by the PMO.
The aim however is that it will be possible to hand over the Programme's capital within the UDLFs 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.It should be insured however that the Program’s capital will continue to be utilised as Revolving Fund for the upland farmers. The modalities still have to be defined in a later stage, amongst others how to ensure future continuation of the UDLF.
In order to reach this aim, it is important that the FSCs will be involved and participate actively in the UDLF as soon as they acquire shares. Capacity building within this context will be done.

UDLF Steering Committee (USC)

Each Upland Development Loan Fund will have its own Steering Committee. This Steering Committee will be organised to oversee the utilisation of the credit fund. In particular, it will be responsible for:

I. formulation and approval of specific policies that will govern the utilisation of the credit fund in the area; especially important will be the formulation of conditionalities in relation to natural resource management measures that have to be implemented before an agricultural loan can be given;

II. endorsement of the UDLF's annual plan and budget to UDP Co-Directors
III. approval of new and expansion of existing FSCs to cover additional communities in the area;
IV. approval of short-term investment plans for any unused balance of the UDLF;
V. monitoring the implementation of the approved UDLF plan and budget.

Any of the shareholders in the UDLF, or its representative, has the right to become a member of the UDLF Steering Committee. Voting powers are distributed following the percentage of shares each of the shareholders has.

In the first year, the UDLF Steering Committee will have probably the following three members: the Rural Finance Officer as chairman, and the PFI representative and the provincial government representative as members. In year 2 or 3, when the FSCs will have become shareholders of the UDLF, the membership of the USC will be expanded to include the two biggest FSC investors of the UDLF.

The USC will meet regularly on at least a quarterly basis.

Technical Working Group (TWG)
A Technical Working Group will be organised to assist the UDLF Steering Committee to prepare the UDLF's annual plan and budget for the area and monitor the implementation of the plan. The UDLF annual plan and budget will integrate the annual area work plans and budgets of the Programme's Rural Financial Services component and those of the PFI. It will include:

I. the activities that will be undertaken by the component and the corresponding targets for the year (including the organisation and strengthening of FSCs and SLGs);
II. the savings and loan targets of the PFI under UDLF for the year;
III. the projected financial statements of the UDLF for the year (i.e. income statement, balance sheet, and sources and uses of funds);
IV. the amount of new funds required for UDLF for the year, including funds for lending and for subsidizing the operating costs of the PFI and the FSCs.

The TWG will be composed of the following members: the Technical Chief of PPO as Head of TWG; the PPO Rural Finance Officer, the PFI Account Manager, the PFI Field Officers and a representative of the provincial government, as members.
The TWG will meet periodically as necessary.

Annual work plans and budgets, especially requests for new credit funds and continuation of subsidies to the PFIs and FSCs will need final approval from the Programme Co-Directors, after recommendation from the Head of the Technical Operation Group.

7. Capital Build Up

Every member of an SLG will be encouraged to buy shares in the FSC. The cost per share is relatively low, P100 per share is suggested. Everybody can have as many shares as s/he wants, but the maximum number of votes is 5 per shareholder. This is done in order to prevent domination by some bigger shareholders.

One is member of the FSC when one has bought at least one share. The FSCs will be requested by the UDP to develop a policy to encourage the increase in number of shares and hence the amount of build up capital. It is anticipated that all members will have 5 shares at the end of the Programme.

Dividend is paid over the shares once per year, after subtracting operating costs, reserve capital and extra build up capital from the profit earned by the FSC in the year. The FSC Management Committee will decide upon the payment of the dividend.

Withdrawal of capital can only be allowed when wanting to withdraw as member of both the FSC and the SLG.

8. Savings

Savings will be encouraged from the very start of the Programme. Methodologies concerning savings will be refined together with the PFI in such a way that they will meet the cash flow patterns and demands by the target group.
PFIs will be encouraged to differ their savings products, in order to meet the various needs by the target group. For example, to give the possibility to invest in time deposits. Cooperatives that are multi-purpose and are trading as well might want to accept savings in kind. Etcetera.

The aim is that members will get free access over their savings and that they can withdraw the savings whenever needed, without giving the purpose of the withdrawal. This free access to savings is deemed to be necessary to encourage poor people to save and to allow them to manage their cash flow in a more sustainable manner. Other experiences have shown that the savings amount increases if people have access to these savings and that the total savings deposit will be higher in the end than when just imposing obligatory savings without access. This strategy however is subject to the agreements with the PFIs.

The SLG, FSC or PFI might decide to limit the access to savings if the person has outstanding loans.

Normal interest rate as paid by the PFI will be used for the savings deposits.

9. Loans

9.1. Loans at FSC level

The first loans will be short term, small amounts and managed by the FSC/PFI. The selection of loanees will depend on their behaviour in the Savings and Loan Groups, their consistency in savings, the guarantee given by the other SLG members and their need for a loan. Production loans will also be assessed on their feasibility. There will be a kind of credit rating for each member developed, to assess their creditworthiness.

The loan amount will be based upon the need for cash. In consultation with the PFIs no direct link between savings amount and loan amount will be pursued. However, one has to be member of the FSC (and hence owning shares) before loans can be availed.

At FSC level, loans can be availed for production, consumption and for emergency needs.

Consumption and emergency loans

Consumption and emergency loans have a maximum of P1000 for the first time and P2000 for each time thereafter. The whole loan has to be repaid before or upon the next harvest.

Production loans

The amount for the first production loans cannot exceed P3,000. Based upon repayment behaviour subsequent production loans can gradually grow in size, but not exceed P12,000.
The first production loan has to be paid back within 6 months, but the actual repayment schedule may need to follow the cash flow generated by the investment. The repayment period for subsequent loans can be extended up till 12 months. Loans needed for periods longer than 12 months will be handled by the PFI and the amount will be disbursed from the UDLF.

Production loan means that the investment of the loan should be in such a way that it will produce income. Within the UDP it is anticipated that most of the production loans will be invested in agriculture, although other non-farm economic activities can be financially supported as well.
For production loans it is required that a short farm plan or business plan will be presented, in which is, amongst others, calculated how the investment can provide enough funds for the repayment of the loan. Furthermore, the farm plan has to include natural resource management. Another condition is that natural resource management measures have already been implemented in the farm before agricultural loans to that farm can be approved. The FSC Management Committee/PFI will be guided by the UDP in the development of the criteria.

Interest rate

The interest charged will have to be enough to cover all operating and financing costs involved after an initial start period of maximally 4 years at FSC level and 3 years at PFI level. The decision about the actual interest rate to be charged will ultimately be left to the FSC Management Committee for loans at community level and the PFI at UDLF level, but it is expected to be in the region of 3% per month as is usual the case in micro-lending in Southern Mindanao or the prevailing market rate.

Default policy

The SLGs and FSCs will be trained to develop a policy for dealing with late repayments and defaults, as it is anticipated that the implementation of such a policy will be the best if the people themselves develop the policy.
The financial system as such should reduce default rate already substantially, with the use of guarantee groups, close monitoring, repayment incentives (access to bigger loans), assessment of the real cash need and adjustment of the repayment schedule to the cash flow generated.

9.2. Loans at UDLF level

Loans to individuals and producer traders organisations that are beyond the capability of the FSCs to finance will come from the UDLF. The sourcing, evaluation and approval of loan applications will be done by the PFI. Loans will include:

- additional funds required by the FSCs for their own lending operations
- all short term individual production loans above P12,000
- medium-term (3 years) loans for post-harvest facilities, farm transport equipment and small irrigation facilities, livestock, perenial crops
- fixed assets, equipment, and working capital requirements of producer trading organisations
- construction or acquisition of FSC offices, including office furniture and equipment

The standard loan packages, including loan terms and conditions, for each of the projects and activities listed above will be prepared jointly by the Programme and the PFIs before the start of the lending operations. The suggested loan interest rates, however, will be as follows:

1. for loans to the FSCs to be used for on-lending, the interest rate from the UDLF should be at most 1.5 percent per month.
2. for loans granted for the construction of acquisition of FSC office buildings, the interest rate should not be higher than 10 percent per annum;
3. for all other loans granted by UDLF, the standard interest rates of the PFI will be used, plus 2 percent per annum which will be recorded as income due to the FSC.

<u>FSC loans for on-lending</u>
The UDLF will provide medium-term loans to the FSCs to further expand their respective revolving loan funds. The maximum amount that an FSC can borrow from the fund will be three times the amount of its shareholding in the UDLF. The actual multiplier that will be used will depend on the following factors:

- the rate of compliance of the FSC to the repayment schedule for the seed capital
- the rate of the FSC members' compliance to their compulsary meetings
- the savings behaviour of FSC members
- the repayment behaviour of FSC members to the FSC

Only FSCs that are not overdue in their repayment of the seed capital, who have good repayment history with the UDLF and the PFI, have at least repaid 50% of the Programme seed capital assistance and have less than 25% of their portfolio at risk[6] will qualify to borrow from the UDLF.
A classification scheme will be used to grade the performance of FSCs to assist in determining their creditworthiness.

9.3. Loans to Special Interest Groups

The main lending function of the FSC is to its members for their individual needs (whether production, consumption or emergency). It is however recognised that some FSC members may also be involved in small-scale group activities (sari-sari stores, crop trading, input supplies). Applications for loans for these group organised activities may be recommended by the FSC to the PFI for feasibility study and loan approval. The FSC must ensure that the members of the applying group have acceptable credit rating within the FSC.

9.4. Special Financing Facility for Producer Marketing Associations

Producer trading organisations might require finance for four purposes:

1. capital equipment
2. recurrent operating costs
3. acquisition and supply of inputs to members on credit
4. purchase of members' produce after harvest

Capital equipment
These different financing requirements each have their own special characteristics. The purchase of capital equipment would require long term financing varying from perhaps five to twenty years depending on the nature of the capital item.

Recurrent costs
Recurrent costs should be largely financed from cash flow with perhaps very short term financing to cater for some valley periods where cash flow is low.

Seasonal credit to members
If producer organisations are to offer an effective service which will challenge the traditional traders it will be essential for them to be able to pay cash for members' produce when it is collected from the farm or delivered into the warehouse. It may also be necessary to provide inputs on credit.

As these organisations will not be in a position to fund these activities from cash flow they will need access to credit.

Loans received from an PFI for this seasonal credit must only be used for this purpose (input supply, crop purchase and direct marketing costs e.g. packaging materials,

[6] portfolio at risk is this part of the loan portfolio where repayment is 30 days or more overdue.

transport hire, etc) and not to fund other costs referred to above. Therefore only organisations that can demonstrate that they have a viable operation which can generate sufficient income to cover their other costs and commitments and have an accounting system which can separate these costs should be considered.

Lending to individual members will need coordination with the FSC. The individual loans for agricultural inputs might come from the FSC, whilst the inputs come from the Producer Trading Organisation. Or, otherwise, if the Producer Trading Organisation decides to give the inputs on credit by themselves, information on the borrowers should be shared between the organisation and the FSC.

Documentation and conditions
Any form of credit should be advanced only on the basis of a properly prepared business plan. Long term credit should be on the basis of a long term plan which should be reviewed regularly and checked against performance. Short term and seasonal credit should be on the basis of short term plans which would include information on crop areas, yield, prices and other costs and market demand information.

Financial statements showing the current performance of the business and its ability to meet its other commitments should be submitted.

Guidelines for preparation of business plans are being prepared under the Marketing and Enterprise Development component.

Capital investments would require the shareholders to contribute 25% equity.

Seasonal credit could be financed 100% if all other conditions are fulfilled.

Responsibility for Approval
General conditions should be reviewed and approved by the Programme Credit Management Committee consisting of the Programme, PFI's and other possible concerned parties. Loans fulfilling the general conditions would be approved by the PFI.

10. Insurance

Participating financial institutions will be encouraged to provide insurance services to their clients in the upland areas. One can think of insurance for death whilst repaying a loan, life insurance, health insurance, burial insurance.

Some financial institutions are already providing several types of insurance to their clients. Some investigation will have to be done to examine the various possibilities as well as to find out the demand by the upland farmers.

11. Seed Capital

After a first 6 months qualifying period, an FSC can apply for seed capital. This seed capital is a loan. The amount of seed capital to be given is calculated on the base of the total amount of capital build-up plus 50% of the total savings amount. The amount of seed capital given is 3 times this amount. The maximum total amount of seed capital to be given per FSC is P100,000.

During the first 18 months after the 6-months period, the FSC can ask for additional funding, as long as the maximum of P 100,000 has not been exceeded. It has been decided to allow a longer period for applying for seed capital in order to avoid the supply-driven savings as was sometimes the case during SMAP (and where people were cheating with the amount saved, in order to get the maximum amount from the project).
After this in total 24 months period or earlier, the FSC must start to pay back the seed capital, into the Upland Development Loan Fund. This repayment shall be done in 36 equal monthly amounts, during maximum 3 years.

An interest rate of 3% above the yearly inflation rate will be charged for the use of the seed capital. This will guard the fund for inflation and will take care of the administrative costs involved. The interest will have to be paid on a monthly basis, also during the first period when no repayment yet will occur.