



Bangko Sentral ng Pilipinas

OFFICE OF THE GOVERNOR

CIRCULAR NO. 570
Series of 2007

Subject: Wholesale microfinance loans granted by universal banks and commercial banks (UBs/KBs), including branches of foreign banks, to microfinance institutions (MFIs), other than banks, as eligible compliance with the mandatory credit allocation to small enterprises

Consistent with the mandate of the Bangko Sentral ng Pilipinas to promote microfinance under Republic Act No. 8791 (The General Banking Law of 2000), the Monetary Board, in its Resolution No. 438 dated 20 April 2007, approved the amendment of the Manual of Regulations for Banks (MORB) as follows:

Section 1. Subsection X342.3 of the MORB is hereby amended so as to include therein an additional provision as follows:

"j. Wholesale microfinance loans granted by universal banks and commercial banks (UBs/KBs), including local branches of foreign banks, to microfinance institutions (MFIs), other than banks, shall be considered as eligible compliance with the mandatory credit allocation to small enterprises: *Provided*, That in addition to their existing internal credit risk evaluation and review mechanisms for prospective and existing exposures, UBs and KBs shall assess the performance of partner-MFIs using the P.E.S.O. Standard."

Section 2. Effectivity. This Circular shall take effect fifteen (15) days after its publication either in the Official Gazette or in a newspaper of general circulation.

FOR THE MONETARY BOARD:


DIWA C. GUINIGUNDO
Officer-in-Charge

24 May 2007

Attachment: The P.E.S.O. Standard

PANANALAPING MATATAG, BANSANG PANATAG

The P.E.S.O. Standard

Uniform Set of Performance
Standards for All Types of
Microfinance
Institutions in the Philippines

PERFORMANCE STANDARDS FOR MFIs

I. Introduction

The National Credit Council (NCC), an inter-agency body chaired by the Department of Finance (DOF) formulated and approved the Regulatory Framework for Microfinance Institutions (MFIs) in July 2002 (**Annex 1**). The framework specifically directed the NCC, in coordination with concerned stakeholders, to formulate and develop a uniform set of performance standards that will cut across all types of institutions involved in microfinance. These standards will serve as the microfinance industry benchmarks to allow the comparison of performance among all institutions engaged in the delivery of microfinancial services. These benchmarks will also guide regulators in the assessment of financial institutions under their supervision. It should be noted, however, that these standards are only applicable to financial institutions that are engaged in retail microfinance operations.

These standards were developed and formulated by the Technical Working Group (**Annex 2**) on Performance Standards for All Types of Microfinance Institutions based on international best practices, industry benchmarks and ratios that are being used by different players in the sector.

II. Purpose of Establishing a Common Set of Standards for Microfinance

As provided for under the Regulatory Framework for Microfinance, a common set of performance standards for all institutions engaged in microfinance was formulated and developed to allow greater transparency in the operations of MFIs. More particularly, the standards will provide the user the necessary basic tools that will facilitate the evaluation and assessment of the operations of MFIs and compare their financial performances, regardless of whether it is a bank, cooperative or an NGO.

The following are expected to use these standards in evaluating the performance of MFIs:

- MFI management;
- Appropriate regulatory authorities;
- Wholesale financial institutions (government and private);
- Donor agencies;
- Domestic and international private sector investors;
- Rating agencies; and
- Social policy institutions.

The indicators and standards could be used in various ways. Management can use these indicators and standards in identifying weak areas in their microfinance operations and determining the appropriate measures to improve operations. Domestic and international private sector investors can use these standards as guideposts in deciding whether they will invest in a certain MFI or not. Wholesale financial institutions, whether private or government can use these standards in assessing the creditworthiness of MFIs while donor agencies, in identifying the type of assistance for a specific MFI.

III. Features of Microfinance

- o Clients come from the low-income and poor sectors, lack assets for collateral, usually self-employed in the informal sector, and engaged in economic livelihood activities;
- o Grant of loans is based on the borrower's household's net cash flow and non-traditional forms of security are acceptable;
- o Loan processing is fast, disbursement is timely and documentation requirement is simple;

- o Microfinancing may be on a group or individual lending basis;
- o Loan sizes are typically small, not exceeding P150,000; and
- o Loans are typically short-term and amortizations are either on a daily, weekly, semi-monthly or monthly basis.

IV. Minimum Criteria in Evaluating Retail Microfinance Institutions

The minimum criteria enumerated below will provide a bird's-eye view of the nature and status of the MFI at a glance. These institutional criteria indicate whether the financial institution employs sound financial practices, has satisfactory performance and stable financial condition. These will also indicate the capability, readiness and seriousness of the financial institution to undertake microfinance operations. These are:

1. Institutional viability criteria

- a. CAMELS rating for banks of at least 3, with management score of not less than 3; and
- b. COOP-PESOS rating of at least 70 for coops with savings and credit services, as prescribed by CDA, provided further that the net institutional capital ratio to total assets as prescribed under the COOP-PESOS is not lower than 5%.

2. Governance

- a. Institution is regularly audited by an independent external auditor. For banks, the auditor should be recognized by the Bangko Sentral ng Pilipinas; for cooperatives, the external auditor should be accredited by the CDA; and for NGOs, the external auditor should be certified by PICPA as a member in good standing.
- b. Audited statements are readily accessible to interested parties.

3. For microfinance operations:

- a. Presence of program objective to reach the poor
- b. No. of active microfinance clients - at least 500 for group lending or 200 for individual lending
- c. At least one year in microfinance operations
- d. Presence of a functioning and effective MIS for regular monitoring of microfinance operations as evidenced by timely generation of accurate basic financial reports, loans tracking, aging report based on portfolio at risk (PAR) and classification of clients by gender
- e. Manual of operations or product manual
- f. At least 2 full time account officers for microfinance operations

V. Performance Standards for Microfinance (See Annex 3 for details)

After complying with the institutional criteria, the microfinance operations of the MFI shall be subjected to the following performance standards:

A. Portfolio Quality - This set of indicators provide specific information on the state of financial health of the microfinance portfolio of the institution. Maintaining good portfolio quality is very important for continued delivery of microfinance services to the MFI's clients. Poor quality of loan portfolio will lead to losses to the institutions, making it difficult to sustain microfinance operations. There are two indicators under this set. These are:

i. Portfolio at Risk (PAR) Ratio - This indicator reflects the proportion of the microfinance loan portfolio with one day missed payment to the total microfinance loans outstanding at a given point of time and shows the degree of riskiness of the total microfinance portfolio. Since microfinance loans are usually very small and are paid using very low amortization payments within a short period of time, the likelihood of default of the entire loan balance is great when one amortization payment is missed.

The formula for this indicator is:

$$\frac{\text{Balance of Loans with At least One Day Missed Payment}}{\text{Total Loans Outstanding}}$$

Restructured loans are loans that have been renegotiated or modified to either lengthen or postpone the original scheduled installment payments or substantially alter the original terms of the loan. Refinanced loans are loans that have been disbursed to enable repayment of prior loans that would not have been paid in accordance with the original installment schedule. **Refinanced loans** shall be classified and treated as restructured loans. Restructured or refinanced loans shall be considered non-performing and shall therefore be included in computing PAR until such time that said loans have been completely repaid.

STANDARD: 5%

ii. Loan Loss Reserve Ratio - This indicates the degree of protection of the institution against expected losses due to delinquency. An allowance should be provided once the microfinance loan is considered at risk, since the likelihood of default increases as amortization payments are missed. Hence, allowance for probable losses is based on portfolio at risk. Restructured and refinanced loans are considered as non-performing and should be provided the appropriate allowance.

The following shall be the basis in computing for the total required allowance for loan loss reserves:

Current	1%
Par 1 to 30	2%
Par 31 to 60 and/or loans restructured once	20%
Par 61 to 90	50%
Par 91 & Above and/or loans restructured twice	100%

- **Loan Loss Reserve Ratio**

STANDARD: Increasing

ii. **Growth in Microfinance Loan Portfolio** - determines the rate of expansion of the MF loan portfolio that may be a result of an increase in the number of clientele or in the loan size amounts granted or a combination of both.

$$\frac{\text{Ending MF Loans Outstanding} - \text{Beginning MF Loans Outstanding}}{\text{Beginning MF Loans Outstanding}}$$

STANDARD: Increasing

iii. **Depth of Outreach** - indicates whether the MFI has provided the necessary micro-financial services to the lower segments of the poor.

$$\frac{\text{Total Loans Outstanding} / \text{Total Number of Borrowers}}{\text{GNP per Capita}}$$

STANDARD: Not exceeding 20%

Note: bring up NGO savings mobilization issue with appropriate authorities - BSP

*All reference to growth rates should be computed on an annual basis. To get growth rate for a specific month, variable should be compared with the performance of the same variable in the previous year. For instance, to get the growth rate of clients as of November 2000, the no. of clients in November, 2000 should be compared with the no. of clients in November, 1999.

VI. Rating System

A. Portfolio Quality (40%)

a. Portfolio At Risk

Score	Equivalent Points
5% or less	20
> 5% to 10%	15
> 10% to 15%	10
> 15% to 20%	5
Above 20%	0

b. Loan Loss Reserver Ratio

Score	Equivalent Points
100%	20
70% to < 100%	15
50% to < 70%	10

C. Sustainability - The set of indicators measures the ability of the institution to generate sufficient revenues to cover the costs of its operations in the long run without any subsidy.

i. **Financial Self-Sufficiency** - indicates whether the organization is earning enough revenue to sufficiently cover in the long-run all operating costs and at the same time maintain the value of its capital and assets, without the need for subsidy.

Operating Revenue

Financial Expense + Loan Loss Provision Expense + Adjusted Expenses

STANDARD: greater than 100%

ii. **Loan Portfolio Profitability** - measures the proportion of net revenues generated from the MF lending operations to the total loan portfolio to determine whether such ratio can sufficiently cover the annual depreciation rate of the peso.

Net Operating Income

Average Net MF Loan Portfolio

STANDARD: greater than the inflation rate during the period

* Full-time MF Staff - refers to those working full-time in microfinance operation regardless of employment status.

* Total Indirect Costs - all personnel and non-personnel costs shared by both microfinance and non-microfinance operation. It includes salaries and benefits, rent, office materials and supplies, publications and publicity, transportation, travel and training for overhead staff, telephone and postage, insurance, utilities, repairs and maintenance, legal, audit and consultant fees, bank charges, taxes, and depreciation.

Adjusted Expenses = Total Operating Expense + [(Average Equity - Average Fixed Assets) x Inflation Rate] + [(Market Interest Rate x Average Total Liabilities) - Actual Interest Expense] + Other Implicit Costs. Other Implicit Costs include those costs relevant to the conduct of its business such as grants, rent free building, donor paid technical advisor, or other subsidized expenses.

D. Outreach - These indicators show the extent and depth of reach of the MFI. The extent of outreach is reflected by the growth in the number of the active clients (referring to those with outstanding MF loans with the institutions) and growth of microfinance portfolio. The depth of outreach is indicated by the ratio of the average loan size to the GNP per capita.

i. **Growth in Number of Active MF Clients** - measures the ability of the MFI to expand its operations through increases in their active clients.

Ending No. of Active MF Clients - Beginning No. of Active MF Clients

Beginning No. of Active MF Clients

Balance of Loans with At Least One Day Missed
Payment
Total Required Allowance

STANDARD: 100%

B. Efficiency - The indicators under microfinance services at the least cost to the institution. They also indicate whether the MFI is able to deliver the ability of the institution to generate sufficient income to cover expenses related to the microfinance operations.

i. Administrative Efficiency - measures the cost of managing the organization's assets.

Administrative Costs (direct and indirect costs)
Average Gross Loan Portfolio

This ratio allocates indirect costs in proportion to the number of personnel directly dedicated to each cost center.

The formula for the ratio is:

MF Indirect Costs = (Number of Full-time MF Staff +
Total Number of Personnel) x Total Indirect Costs

STANDARD: 10 % and below

ii. Operational Self-Sufficiency - indicates whether or not enough revenues has been earned to cover the organization's costs.

Interest Income from Loans + Service Fees + Filing
Fees + Fines, Penalties, Surcharges
Financing Costs + Administrative Costs (direct and
indirect costs)*

*Administrative cost should include loan loss
provision expense

STANDARD: greater than 120%

iii. Loan Officer Productivity

Number of Active Borrowers
Number of Account Officers

**STANDARD: Group: greater than or equal to
300**

Individual: greater than or equal to 150

30% to < 50%	5
Below 30%	0

B. Efficiency (30%)

a. Administrative Efficiency

Score	Equivalent Points
0 to 10%	10
> 10% to 15%	6
> 15% to 20%	4
Above 20%	0

b. Operational Self-Sufficiency

Score	Equivalent Points
120% & abover	10
115% to < 120%	8
110% to < 115%	6
105% to < 110%	4
100% to < 105%	2
Below 100%	0

c. Loan Officer Productivity

Score	Equivalent Points
For Group Loans:	
300 and above	5
250 to 299	3
200 to 249	1
Below 200	0
For Individual loans:	
150 and above	5
100 to 149	3
50 to 99	1
Below 50	0

Note: If MFI is using only one methodology, MFI gets an additional 2.5 points.

C. Sustainability (15%)

a. Financial Self-Sufficiency

Score	Equivalent Points
100% & above	10
95% to < 100%	8
90% to < 95%	6
85% to < 90%	4
80% to < 85%	2
Below 80%	0

b. Loan Portfolio Profitability

Score	Equivalent Points
Greater than inflation rate	5
Equal to inflation rate	3
Less than inflation rate	0

D. Outreach (15%)

a. Growth in Number of Active Microfinance Clients

Score	Equivalent Points
5% or higher	5
0 to 5%	3
Below 0	0

b. Growth in Microfinance Loan Portfolio

Score	Equivalent Points
5% or higher	5
0 to 5%	3
Below 0	0

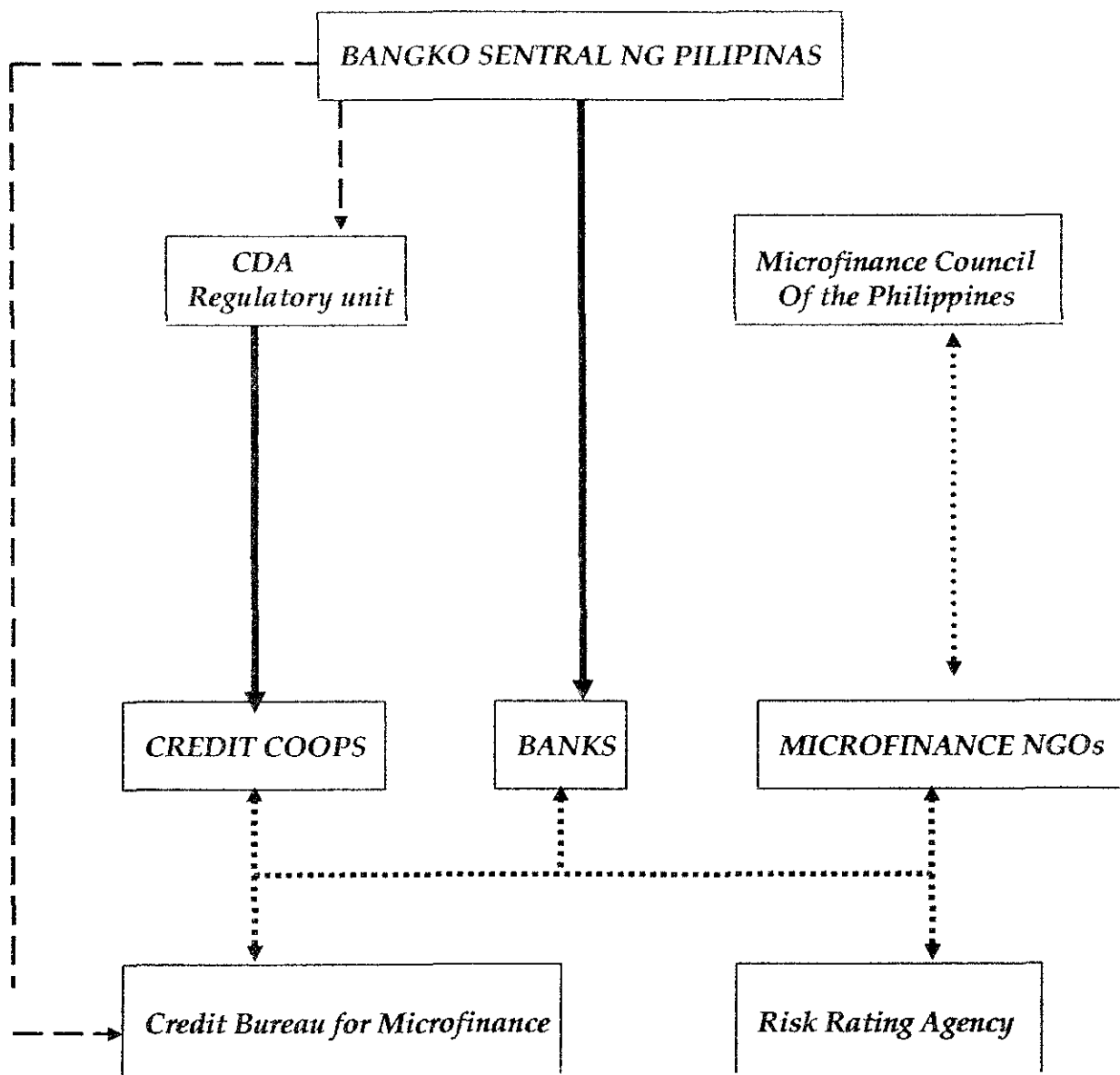
c. Depth of Outreach

Score	Equivalent Points
<20%	5
> 20-100%	4
> 100-150%	3
> 150-200%	2
> 200-300%	1
> 300%	0

VII. Overall Adjectival Rating

- Rating 1 (90 to 100) - Excellent. The MFI has strong performance that provides safe and sound operation. The microfinance operations of institutions in this category are resistant to external shocks and financial disturbances and are able to withstand adverse changes in the business environment.
- Rating 2 (80 to 89) - Very Satisfactory. The MFI has satisfactory performance. They have safe and sound operations and are able to withstand business fluctuations. However, there are some areas in its operations that need special attention which, if left unchecked may negatively affect its microfinance operations.
- Rating 3 (70 to 79) - Satisfactory. There are areas in the microfinance operations that need special attention. Key performance measures indicate that safe and sound operations may be adversely affected and may deteriorate further when left unchecked.
- Rating 4 (Below 70). The microfinance operation has serious problems and needs closed supervision.

ANNEX I
Proposed Institutional Set-up for the Regulation of Microfinance



Legend:

Direct supervision —————

Oversight - - - - -

Submission and assessment of relevant information>

Annex 2

Members of the Technical Working Group (TWG)

The Technical Working Group is comprised of representatives from the following:

- *Bangko Sentral ng Pilipinas (BSP)*
- *Cooperative Development Authority (CDA)*
- *Credit policy Improvement Program (CPIP)*
- *Credit Union Empowerment and Strengthening (CUES) Program in Mindanao*
- *Department of Finance (DOF)-National Credit Council (NCC)*
- *Department of Labor and Employment (DOLE)*
- *Development Bank of the Philippines (DBP)*
- *Land Bank of the Philippines (LBP)*
- *Microenterprise Access to Banking Services (MABS)*
- *Microfinance Council of the Philippines (MCPI)*
- *National Anti-Poverty Commission (NAPC)*
- *National Confederation of Cooperatives (NATCCO)*
- *National Economic and Development Authority (NEDA)*
- *People's Credit and Finance Corporation (PCFC)*
- *Philippine Deposit Insurance Corporation (PDIC)*
- *Rural Bankers Association of the Philippines (RBAP)*
- *Securities and Exchange Commission (SEC)*

Annex 3

Summary of the Performance Standards for Microfinance (P.E.S.O.)

Area	Indicator	Definition/Ratio	Standard	Weight
PORTFOLIO QUALITY				
	Portfolio at Risk	Balance of loans with at least one day missed payment Total Loans Outstanding	PAR - 1 5 %	20
	Loan Loss Reserve Ratio	Total Allowance Provided Total Required Allowance	Required Reserves: Current - 1% PAR 1 to 30 - 2% PAR 31 to 60 - 20% PAR 61 to 90 - 50% PAR 91 & above and/or loans restructured twice - 100%	20
EFFICIENCY				
	Administrative Efficiency	Administrative Costs ^{1/} (Direct & Indirect Costs ^{2/}) Average Gross Loan Portfolio ^{3/}	10% & below	10
	Operational Self-sufficiency	Interest Income from Loans + Service Fees + Filing Fees + Fines, Penalties, Surcharges Financing Costs + Administrative Costs (Direct & Indirect costs)	≥ 120%	10
	Loan Officer Productivity	Number of Active Borrowers Number of Account Officers	- Group - ≥ to 300 - Individual - ≥ to 150	10
STAINABILITY				
	Financial Self-sufficiency	Operating Revenue Financial Expense + Loan Loss Provision Expense + Adjusted Expenses ^{4/}	≥ 100%	10
	Loan Portfolio Profitability	Net Operating Income Average Net MF Loan Portfolio	Greater than inflation rate during the period	5

Area	Indicator	Definition/Ratio	Standard	Weight
REACH				
	Growth in Number of Active MF clients	$\frac{\text{Ending No. of Active MF Clients} - \text{Beginning No. of Active MF Clients}}{\text{Beginning No. of Active MF Clients}}$	Increasing	15
	Growth in Microfinance Loan Portfolio	$\frac{\text{Ending MF Loans Outstanding} - \text{Beginning MF Loans Outstanding}}{\text{Beginning MF Loans Outstanding}}$	Increasing	5
	Depth of Outreach	$\frac{\text{Total Loans Outstanding} \div \text{Total Number of Borrowers}}{\text{GNP per Capita}}$	20% or below	5
				100

Administrative cost should include loan loss provision expense.

$$\frac{\text{Beginning Gross Loan Portfolio} + \text{Ending Gross Loan Portfolio}}{2}$$

Indirect Costs is allocated in proportion to the number of personnel directly dedicated to each cost center. Indirect cost allocated to the microfinance operations is computed as:

$$\text{Indirect Costs} = (\text{Number of Full-time MF Staff} \div \text{Total Number of Personnel}) \times \text{Total Indirect Costs}$$

Where:

- **Full-time MF Staff** -- refers to employees working full-time in the microfinance operations regardless of employment status, i.e., whether contractual or regular.
- **Total Indirect Costs** -- refers to costs shared by both the microfinance and non-microfinance operations. It includes, among others, salaries and benefits, rent, office materials and supplies, publications and publicity, transportation, travel and training for overhead staff, telephone and postage, insurance, utilities, repairs and maintenance, legal, audit and consultant fees, bank charges, taxes, and depreciation.

$$\text{Adjusted Expenses} = \text{Total Operating Expense} + [(\text{Average Equity} - \text{Average Fixed Assets}) \times \text{Inflation Rate}] \div [(\text{Market Interest Rate} \times \text{Average Total Liabilities}) - \text{Total Interest Expense}] + \text{Other Implicit Costs}$$

Other Implicit Costs include those costs relevant to the conduct of its business such as grants, rent free building, donor aid technical advisor, or other subsidized expenses.

Active MF clients shall be those clients with savings and/or loans.