ADBI Working Paper Series

Credit Surety Fund: A Credit Innovation for Micro, Small, and Medium-Sized Enterprises in the Philippines

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No. 586
July 2016

Asian Development Bank Institute

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The Working Paper series is a continuation of the formerly named Discussion Paper series; the numbering of the papers continued without interruption or change. ADBI's working papers reflect initial ideas on a topic and are posted online for discussion. ADBI encourages readers to post their comments on the main page for each working paper (given in the citation below). Some working papers may develop into other forms of publication.

Suggested citation:

Maningo, G. V. 2016. Credit Surety Fund: A Credit Innovation for Micro, Small, and Medium-Sized Enterprises in the Philippines. ADBI Working Paper 589. Tokyo: Asian Development Bank Institute. Available: http://www.adb.org/publications/credit-surety-fund-credit-innovation-micro-small-and-medium-sized-enterprises-philippines/

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Abstract

Micro, small, and medium-sized enterprises are a backbone of the Philippine economy. One factor that hinders the growth of these enterprises is their difficulty in accessing finance from banks and other financial institutions. The Credit Surety Fund (CSF) was established to help these enterprises and other organizations become creditworthy and bankable. The CSF is a credit guarantee program initiated by the Bangko Sentral ng Pilipinas that enables enterprises and cooperatives to gain easier access to loans from banks without providing collateral. The CSF pools contributions from cooperatives and nongovernment organizations, local government units, institutions such as the Development Bank of the Philippines, the Land Bank of the Philippines, the Industrial Guarantee and Loan Fund, and other organizations. In this way, it is a public–private partnership that links the key players of the economy to empower enterprises and cooperatives.

JEL Classification: G21, G24, G32

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1. INTRODUCTION

The Credit Surety Fund (CSF) is a credit guarantee program in the Philippines initiated by the Bangko Sentral ng Pilipinas (BSP), the country's central monetary authority, to help micro, small, and medium-sized enterprises (MSMEs) gain access to credit. It improves the bankability and creditworthiness of capital-short enterprises, including cooperatives, which have difficulty in obtaining bank loans due to lack of collateral, credit information, and an established credit track record. The CSF is financed by the pooled contributions of various stakeholders, including cooperatives, local government units, and government financial institutions (Land Bank of the Philippines, Development Bank of the Philippines, and Industrial Guarantee and Loan Fund). The pool of funds serves as security for loans to enterprises from banks in lieu of conventional collateral.

The beneficiary of the program is the MSME sector, which is an important driver of the Philippine economy owing to its large contribution in terms of jobs generated and by the sheer number of enterprises, which make up more than 99% of all registered firms nationwide. However, studies indicate that one of the key factors inhibiting the development of MSMEs is the lack of access to finance, particularly loans.

Unlike conventional credit guarantee schemes, the CSF has a broader range of funding sources, with partnerships with local government units, government financial institutions, cooperatives, and private banks. The program is national in scope but implemented locally. A fund may be organized in a specific city or province, or in partnership with a particular local government unit. Such a CSF is a separate entity with regard to other CSFs, and has its own set of officers.

Since 2007, the CSF has been growing rapidly with 37 individual CSFs in operation at the end of 2014. Funding contributions have reached $10.5 million and total accumulated approved loans have reached $33.8 million. Of total approvals, $27.8 million has been released to 14,434 MSMEs.

There remain key challenges to be addressed including the institutionalization of the program, more rapid processing of loan applications, and increases in the quality of credit information. In any case, the CSF has proven to be successful and has plans and strategies to further improve its operations and expand coverage to establish more local CSFs, expand the portfolio of loans covered, and increase the number of MSME loan beneficiaries.

2. MICRO, SMALL, AND MEDIUM-SIZED ENTERPRISES AS KEY DRIVERS OF THE PHILIPPINE ECONOMY

Small businesses play a vital role in reducing poverty, creating jobs, and promoting inclusive economic growth. MSMEs are often dubbed as the drivers of the Philippine economy as they continue to dominate the business sector in terms of the number of establishments and jobs created.

As provided in the Republic Act 9501, MSMEs are defined as business entities, whether single proprietorship, cooperative, partnership, or corporation. Size is based on assets and ranges from up to $66,667 for micro, up to $333,333 for small, and up to $2.2 million for medium-sized businesses (Table 1).

Table 1: Definitions of Micro, Small, and Medium-Sized Enterprises according to Asset Base

Type of Enterprise	Asset Base
Micro enterprise	$0 to $66,666
Small enterprise	$66,667 to $333,333
Medium-sized enterprise	$333,334 to $2.2 million
Large enterprise	Above $2.2 million

Source: Philippine Government. 2008. Magna Carta for Micro, Small and Medium Enterprises (Republic Act 9501), Sec. 3.

About 99.6% (940,921) of registered firms nationwide are classified as MSMEs and the remainder is made up of large enterprises (Philippine Statistics Authority 2013). In itself, the figure appears staggering but when one considers the total population of the Philippines, which now stands at 100 million, this is only 1 enterprise for every 100 Filipinos and is lower than most other Asian countries.

The MSME sector is the biggest employer with about 62% of the workforce working for an MSME. Thus, they play a very important role in providing employment in both rural and urban areas and contribute to equitable income distribution. They account for 35.7% of gross domestic product (GDP) (Department of Trade and Industry 2013). The Philippine government and stakeholders hope to increase the GDP contribution to 40% by the end of the current MSME Development Plan (2011–2016) so that it is on par with neighboring countries (MSMED Council n.d.).

As inviolable as they may seem, the fact is that many MSMEs in the Philippines remain fragile, immature, and undeveloped. There is a need for them to realize their full potential and enhance their competitiveness. This can be achieved in part by providing sustainable and effective support mechanisms, such as access to credit, through the assistance of the government and the private sector.

3. ACCESS TO FINANCE: A KEY GROWTH FACTOR

3.1 Current Scenario

Survey data from the Philippine National Strategy for Financial Inclusion indicate that 47% of adult Filipinos borrow money, but most loans come from informal sources like family and friends (62.0%) and informal lenders (10.0%). Formal institutions provided a much smaller share, including lending and financing companies (12.0%), cooperatives (10.5%), microfinance nongovernment organizations (9.9%), and banks (4.4%). More than 85% of the survey's respondents indicated that they wanted to access financial services from formal institutions.

Insufficient lending to the enterprise sector constrains economic development. Only 13% of Filipino SMEs have access to bank loans to finance investment and working capital, considerably lower than in other Asian countries. Only 6% of capital formation is financed by banks and another 6% is funded by other external sources. Increasing the level of externally funded capital in Filipino SMEs from 12% to 50% could create 7 million additional jobs (Bridge Financial Services 2010).

A recent report by the Asian Development Bank (2015) indicates that SME loans in the Philippines were equal to only 3.1% of GDP—the second lowest in Southeast Asia after Myanmar. It also lagged behind its neighbors in terms of the share of SME loans to total loans at 10.3% (ADB 2015). These indicators suggest that more needs to be done to channel finance to enterprises in the Philippines.

3.2 Philippine MSME Development Plan

The Philippine MSME Development Plan (2011–2016) considers access to finance as a critical factor affecting global competitiveness. Access to finance is the sustained availability of reasonably priced, socially responsible, and environment-friendly financial products, services, and support programs that are designed for MSMEs and that MSMEs can conveniently and readily access. Some of the important stakeholder concerns regarding access to finance and indicated in the MSME Development Plan are synthesized in Table 2.

Table 2: Synthesis of Access to Finance Concerns

1. Funds are available but micro, small, and medium-sized enterprises (MSMEs) find these difficult to access because of stringent and voluminous documentary requirements as well as the slow processing time of their loan applications.
2. MSMEs find it difficult to borrow funds from banks because of the collateral requirements.
3. MSMEs find the minimum loan amount requirement and the short repayment period restrictive.
4. The financial packages for MSMEs in several regions are only available in urban areas.
5. There is a mismatch of financing programs for MSMEs. MSMEs in several regions lack the capacity for financial management.
6. MSMEs in several regions do not have the capacity to borrow from formal sources.
7. MSMEs do not have access to venture capital funds.
8. It is difficult to restructure loans.
9. MSMEs have limited access to information regarding the sources of funds for MSMEs and on how to access these funds.
10. Financial institutions do not consider the environment when they lend to MSMEs.
11. The interest rate charged by financial institutions to MSMEs is very high.
12. There is lack of government financial support to MSMEs.
13. Banks in several regions are not keen on lending to MSMEs.
14. Policies related to access to finance are not gender-responsive.
15. There are no funds available for start-up MSMEs in several regions.
16. Government-owned and -controlled corporations’ funds for MSMEs are not well utilized.

Source: Micro, Small, and Medium Enterprise Development (MSMED) Council. 2012. MSME Development Strategy. p. 22. MSMED Council MSME Development Plan 2011–2016.

The same plan also outlined eight result statements (Table 3) describing a level of access to financing to realize the MSME development goals (MSMED Council 2012).

3.3 The Financial Gap

It is convenient to think that banks and other financial institutions should step in and solve this problem right away. Liberalize policies and rules if needed. But for banks, lending to MSMEs is a challenge due to the lack of qualified collateral, a good credit history, and quality credit information that enables them to determine creditworthiness. Simply put, the credit risk involved is too high for most banks.

Table 3: Access to Finance Outcome Portfolio

1. The financial products, services, and support programs that micro, small, and medium-sized enterprises (MSMEs) need are sustainably available and accessible even for start-up MSMEs and those in the countryside.
2. The cost of obtaining MSME loans is reasonable and affordable.
3. The requirements that MSMEs need to comply with to obtain loans are reasonable and manageable.
4. The process that MSMEs need to follow and documents that must be submitted to obtain loans are simplified and streamlined.
5. MSMEs are trained in financial management and are able to understand and speak the language of financial institutions, while financial institutions are trained to understand and speak the language of MSMEs.
6. Financial products and services for MSME lending are gender-responsive and environment-friendly.
7. The information needed by MSMEs to access financial resources is available and easily accessible.
8. The assistance extended by stakeholders to MSMEs in accessing funds is coordinated, responsive, and effective.

Source: Micro, Small, and Medium Enterprise Development (MSMED) Council. 2012. MSME Development Strategy. p. 28. MSMED Council MSME Development Plan 2011–2016.

Thus the financing gap prompts MSMEs to rely on informal sources of financing—families and relatives. They also rely on moneylenders who provide the infamous "5-6 financing" with very high interest rates and other unfavorable terms. It is called "5-6 financing" because for every $5 borrowed over a period of say 1 week, the borrower must repay $6, thus an interest payment of $1 or 20%. Collection of payment is also made daily, which makes the arrangement burdensome for the borrowers.

There are several factors that contribute to the MSME financial gap (Table 4). Primarily, there is a mismatch between the needs of MSMEs and the supply of financial services. This explains why lending to MSMEs is low.

Table 4: Factors Affecting the Financial Gap

Banks	Micro, Small, and Medium-sized Enterprises
Fear of unsecured loans	Lack of acceptable collateral
Prefer big loans	Lack of knowledge on credit sources and processes
High transaction cost	Fear of dealing with banks
Lack of credit information	Onerous documentation requirements

MSMEs' limited access to financing is a result of a mismatch between their needs and what banks are willing to provide. On the supply side, banks avoid providing financing to MSMEs due to lack of collateral and a repayment track record. The lack of credit information also deters banks from lending to MSMEs as it is more difficult to determine their creditworthiness; hence, the risk is high. Moreover, the cost of obtaining credit-related information is high due to inconsistent financial statements and audits, and the lack of reliable third-party sources of quality credit information.

On the demand side, MSMEs are unable to qualify for credit primarily due to lack of acceptable collateral such as real estate. MSMEs may also be unable to comply with strict loan documentation requirements. Instead, most MSMEs rely on internal sources of financing while some go to informal sources that charge high interest rates. This financial environment is unlikely to sustain the growth of the sector. MSMEs need to be creditworthy and bankable.

3.4 Compliance with the MSME Magna Carta Law

The Philippine government has not been indifferent to finding solutions to the problem of SME finance. In 2008, the Republic Act 9501, otherwise known as the Magna Carta for MSMEs, was passed and declared that the state shall promote, support, strengthen, and encourage the growth and development of MSMEs and shall ensure that MSMEs' continuing viability and growth are attained by (i) facilitating access to finance, (ii) complementing and supplementing financing programs and eliminating stringent and burdensome collateral requirements, and (iii) instituting safeguards for the protection and stability of the credit delivery system.

An important feature of the law is the mandatory allocation by all lending institutions of at least 8% of the total loan portfolio to micro and small enterprises and 2% to medium-sized enterprises. The objective of the law is to force banks to lend to MSMEs. If they do not meet the prescribed levels, the lenders must pay a penalty.

While the objective of the law is laudable, the results have been discouraging. At the end of 2014, banks lent on average only 4.9% of their portfolio to micro and small enterprises, much below the 8.0% threshold and lower than the previous year (5.6%) (Table 5). The difference between what was lent and the threshold amounted to $2.76 million. A significant number of banks did not achieve the mandatory lending requirement and many simply opted to pay the penalty ($11,111 per bank) rather than assume the risk of financing MSMEs. Regarding the 2.0% requirement for medium-sized enterprises, there was over compliance, with the average reaching 6.1% (BSP Supervisory and Examination Sector Supervisory Data Center 2015).

Table 5: Compliance with MSME Loan Requirements, Philippine Banking System
(% as of yearend)

	2008	2009	2010	2011	2012	2013	2014
A. Micro and small enterprises	10.0	9.7	8.5	7.6	6.4	5.6	4.9
B. Medium enterprises	9.0	8.2	7.9	7.6	6.9	6.1	6.1

Source: BSP Supervisory and Examination Sector Supervisory Data Center.

4. BRIEF OVERVIEW OF THE CREDIT SURETY FUND

4.1 Conceptualization

The BSP has a constitutional mandate to provide policy direction in the area of money, credit, and banking. Legislative endeavors to specifically encourage finance to MSMEs include the Magna Carta for MSMEs, the Barangay Micro Business Enterprises Act,[1] and others. The CSF is an additional initiative in this area and was launched in 2008 in the province of Cavite.

The CSF is of national relevance but it is implemented at the provincial and city levels for greater flexibility, more efficient administration, and easier access and reach to the

[1] Republic Act No. 9178, also known as the Barangay Micro Business Enterprises (BMBEs) Act of 2002, promotes the establishment of BMBEs and provides for related benefits such as tax incentives and financial support.

end beneficiaries, which are cooperatives and MSMEs in the countryside. The Credit Innovation and Advancement Group of the BSP Department of Loans and Credit is in charge of promoting, organizing, monitoring, and supporting capability enhancement for CSFs. BSP provides the support necessary to expand the program and make it more sustainable by (i) providing capability building training programs to stakeholders and beneficiaries and (ii) providing liquidity support to the banking industry by making loans covered by the CSF re-discountable under its regular rediscounting facility.

4.2 The Credit Surety Fund at a Glance

The CSF is a credit guarantee system for MSMEs experiencing difficulty in obtaining bank loans due to their lack of acceptable collateral, credit knowledge. and credit track record. The CSF provides security (i.e., a guarantee) on bank loans to MSMEs in lieu of collateral. The guarantee reduces the risk to the bank of lending to these enterprises. The CSF program also provides capacity building to address concerns regarding the borrower's lack of knowledge on credit sources and processes with regards to MSME or business loans.

4.3 Types of Credit Guarantee Systems

There are different types of guarantee systems, distinguished not by terminologies but generally by purpose and the type of ownership. Five major types of guarantee systems can be identified: mutual guarantee associations, publicly operated national schemes, corporate schemes, bilateral or multilateral cooperation schemes, and nongovernment organization (NGO) schemes. Schemes can be divided according to the operational mechanism used (i.e., selective, portfolio, or intermediary approaches) (Green 2003).

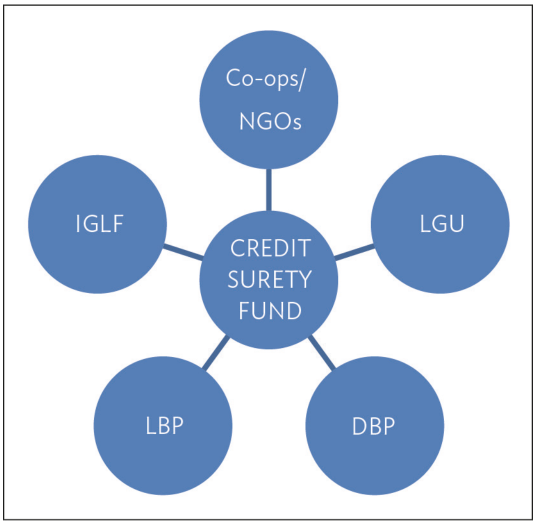
In the Philippines, the existing guarantee systems are publicly operated national schemes that are owned by the government and operated by an agency or unit of government or by an entity with a separate juridical entity but organized by the government. The system requires periodic appropriations of public funds, such as continued subsidies or a fixed fund.

But the CSF is a unique hybrid type of guarantee, as it combines the features of other schemes (mutual guarantee associations, corporate guarantee schemes, and public guarantee schemes). The CSF is based on partnership and cooperation among different stakeholders, both public and private, including cooperatives, NGOs, associations, and the MSMEs themselves. This broad membership makes the CSF more expansive and flexible in catering to the varying needs of MSMEs.

4.4 Creation and Organization

The creation of CSF stems from the *bayanihan*—a Filipino custom referring to the spirit of communal unity, work, and cooperation to achieve a particular goal. The fund is generated from contributions of the cooperatives and nongovernment organizations with counterpart funding from the local government units (Figure 1). Other government financial institutions are also part of the program: the Development Bank of the Philippines,
the Land Bank of the Philippines, and the Industrial Guarantee and Loan Fund. The contributions are placed in a trust fund managed by a trustee bank and used as a guarantee for MSME loans.

Figure 1: Composition of a Credit Surety Fund Organization



Co-ops = cooperatives, DBP = Development Bank of the Philippines, IGLF = Industrial Guarantee and Loan Fund, LBP = Land Bank of the Philippines, LGU = local government unit, NGO = nongovernment organization.

4.5 Participation in the CSF Program

Only well-capitalized and well-managed cooperatives that are organized under the provisions of Republic Act No. 9520 (otherwise known as the Philippine Cooperative Code), including cooperative banks and NGOs, may contribute or invest in the CSF. In order to be considered as well-capitalized, a cooperative must have an adjusted capital of at least $22,222[2] and an adjusted capital-to-asset ratio of at least 15%.[3] The minimum contribution to the fund is set at $2,222.

4.6 Oversight Committee

The CSF is governed by the Oversight Committee, of which a majority of the members are elected by member cooperatives and NGOs and ex-officio members representing the local government units and other institutions. Similar to a board of directors, the Oversight Committee is responsible for proper administration and overall management. It formulates rules and regulations governing CSF operations, provides criteria for admission of new members, issues surety cover, decides on the investment policies, and selects the trustee bank.

4.7 Trust Fund

The funds generated provided by the stakeholders are deposited in a trustee bank. The trustee bank administers the fund and invests it in safe investment securities such as government treasury bills and bonds. This fund will be used as security or collateral for MSME loans.

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2 Adjusted capital computed as total equity minus all past due loans and loans under litigation (net of allowance for probable losses), plus dividends payable.

3 Adjusted capital-to-asset ratio is computed as adjusted capital divided by adjusted total assets (computed as total assets less past due loans and loans under litigation net of allowance for probable losses).

4.8 Qualified Borrowers and Beneficiaries

As provided in BSP guidelines, two types of borrowers are qualified to apply for surety cover under the CSF program:

(i) contributor-cooperatives or NGOs engaged in any business activity, or

(ii) MSMEs that are members in good standing of a contributor cooperative or NGO.

Further, a MSME borrower must be endorsed by a cooperative that is a member of CSF in order to qualify for the program. In case the end-user borrower is a primary cooperative and the purpose of the loan is for its own business activity, including relending to its members, the endorsement is provided by a secondary cooperative or federation or other member cooperatives, or directly by the Oversight Committee.

The loan of the end-user borrower must be used for productive activities such as additional working capital, acquisition of equipment, purchase of goods, additional inputs for agricultural and commercial projects, and lending.

4.9 Loan Capacity and Other Limitations

The BSP guidelines and CSF internal rules and regulations require that in providing surety, CSF will implement the following two risk management and prudential measures:

(i) The aggregate amount of loans covered by the surety undertaking of the endorsing cooperative may not exceed 10 times the amount of the cooperative's contribution to the fund.

(ii) The aggregate amount of outstanding loans granted by all participating banks shall not exceed 5 times the outstanding aggregate amount of contributions to the CSF by all cooperatives, (local government units), other government agencies, and nongovernment organizations or entities.

4.10 Mechanics in Access and Collection

Obtaining CSF coverage. To obtain CSF coverage, a three-tier evaluation process is used involving the cooperative, the CSF Oversight Committee, and the lending bank: (i) the cooperative evaluates the loan and endorses it to the Oversight Committee, (ii) the Oversight Committee evaluates the loan and if appropriate issues surety cover in favor of the borrower to the participating bank, and (iii) the lending bank receives the loan application supported by surety cover and releases the loan directly to the MSME borrower or through the cooperative.

Collection Process in Case of Default. The collection process in case of default reverses the three steps in loan assessment discussed above. First, the lending bank files a claim against the CSF after the loan has become past due following the guidelines prescribed by the BSP on the definition and treatment of past due loans. Second, after reviewing the validity of the bank's claim and completion of the submitted documents, the Oversight Committee pays the lending bank. Third, after paying the claim of the lending bank, the CSF endorses to the original endorsing cooperative or NGO the claim, together with the loan and other documents received from the lending bank, for collection. Any payments made by the end-user borrower on the past due loan to the endorsing cooperative must be remitted to the CSF.

4.11 Other Important Features of the CSF

There are three other interesting features of CSF. First, a cooperative may endorse loans or directly borrow from CSF up to a value that is 10 times its contribution to the fund. Second, the CSF covers 80% of the loan value at inception but coverage rises to 90% when 30% of the loan has been repaid. Coverage rises further to 100% once 60% of the principal has been repaid.

Third, although the fund is a nonprofit endeavor, the CSF and the endorsing cooperatives may charge an annual surety fee of up to 5% of the loan value. This fee is in addition to the interest charged by the bank. Some CSFs charge as low as 1% depending on the risk exposure and risk appetite. CSFs may charge 5% for riskier loans, which adds significantly to the cost of the loan for the borrower.

5. OTHER CREDIT GUARANTEE SCHEMES IN THE PHILIPPINES

There are five other guarantee schemes in the Philippines. Two of these—the Industrial Guarantee Loan Fund (IGLF) and Small Business Corporation—serve a purpose similar to the CSF and are discussed below. The three other schemes are not focused on MSMEs. The Philippine Export-Import Credit Agency provides support for exporters, whereas the agriculture sector is served by the Agricultural Guarantee Fund Pool and the Quedan and Rural Credit Guarantee Corporation.

The IGLF is currently managed by the Development Bank of the Philippines (DBP) and was previously under the BSP. Its primary target is the MSME sector. It has not provided direct guarantees for quite some time. Instead, it provides wholesale loans through DBP to banks and other financial institutions for relending to MSMEs. It also provides retail loans facilitated by DBP directly to MSMEs. It has very few personnel and they are detailed from DBP. It maintains a single office in Manila and has no regional operations. However, IGLF is a pioneer stakeholder in the CSF with a total contribution of $1.7 million. The IGLF received an award from the BSP as the CSF's most outstanding partner because it provides additional funding for capacity building training activities and seminars for the benefit of program beneficiaries.

Small Business Corporation's primary mandate is also to support and develop the MSME sector. Its public guarantee scheme is among the most active and is wider in scope because its services are directed toward the MSMEs themselves. It maintains satellite offices in the Visayas and Mindanao regions.

Before the CSF began, Small Business Corporation was the most prevalent guarantee scheme in the Philippines. It is organized as a government corporation and is fully funded by the national government with seed capital of $22.2 million and current capital of $42.2 million. Its services go beyond providing credit guarantees and include direct and indirect lending, financial leasing, secondary mortgages, venture capital operations, and the issuance of debt instruments for compliance with the mandatory allocation provision.

Its credit guarantee portfolio was $4.6 million in 2014, benefiting only 119 MSMEs, whereas its wholesale and retail lending portfolio was $16.2 million. The number of its MSME borrowers was 1,253. Also, microfinance wholesale lending reached $28 million in the same year. Small Business Corporation is more focused on lending than on providing credit guarantees.

Its limited funding and capitalization also limits its capacity to grow its portfolio and help more MSMEs. Jesus Tambunting, chair of Small Business Corporation, is aware that there is a problem with its credit guarantee facility. He recently stated, “We already have a guarantee program but we have not fully developed it. Not many banks can make use of it. I think we have to review it and see if we can make it even more attractive so that more banks can make use of that guarantee” (Miraflor 2015).

The CSF and Small Business Corporation could augment and complement each other in supporting credit to MSMEs. However, the two organizations work differently in some ways. For example, the CSF is not a wholly owned government corporation, but a public–private partnership, with funds coming from the government and private sector. Other notable differences are provided in Table 6.

Table 6: Comparison of Credit Surety Fund and Small Business Corporation Credit Guarantees

	Small Business Corporation	Credit Surety Fund
Originator	National government (Department of Trade and Industry)	BSP
Funders	Government and international NGOs	Local government units, GFIs, NGOs, cooperatives
Type of Coverage	Guarantee	Surety
Coverage Ratio	80%	80% but 100% of the remaining balance if 60% of principal is paid
Co-guarantor/Surety	None	Endorsing cooperative or NGO

BSP = Bangko Sentral ng Pilipinas, GFI = government financial institution, NGO = nongovernment organization.

In legal terms, there are significant differences between a guarantee and a surety, and such differences probably make the latter more attractive to banks. With a surety, the entity that issues surety cover binds itself solidarily with the principal debtor; however, in a guarantee, the guarantor is only subsidiarily liable to the creditor if the borrower does not pay. Also, in case of default, the creditor has to exhaust all remedies of collection before the creditor can collect from the guarantor.

6. BENEFITS OF THE CREDIT SURETY FUND

6.1 MSMEs

Through the CSF program, a share of MSMEs now has easier access to formal financing. MSMEs are made bankable and enjoy significantly lower interest rates than those charged by informal sources. This allows MSMEs to compete with large firms on a more level playing field. MSMEs can also benefit from the Capability Enhancement Program through training and seminars in the areas of management, marketing, and finance (discussed in section 14).

6.2 Cooperatives and NGOs

Cooperatives and NGOs play a vital role in the operation of CSFs. These groups address the gap separating MSMEs and the banking community. Cooperatives are ideally suited as key partners in the program design because they are owned and run by MSMEs. Apart from that, the statistics are enormously favorable, given that there are more than 23,000 cooperatives in the Philippines with total membership of

12 million people. However, cooperatives have limited funds to serve the credit needs of their members. Instead of denying their members the much-needed credit, the cooperatives can endorse the loans to the CSF. In this way, the CSF benefits the participating cooperatives by providing their members of good standing with access to bank credit. By participating in the program, cooperatives may expand due to an increase in membership. Cooperatives can also benefit from training under the Capability Enhancement Program.

6.3 Banks

The CSF helps banks comply with the credit allocation requirements micro and small enterprises. It significantly reduces credit risk as the CSF substitutes for hard collateral. Further, banks can avail themselves of the BSP's rediscounting facility for loans covered by the CSF.

6.4 Local Government Units

Local government units will now have a mechanism to address the need of small entrepreneurs in their area. The CSF encourages more business activity, which may create more jobs, raise tax revenue, and improve the local economy.

7. THE CSF COMPLEMENTS EXISTING MICROFINANCE PROGRAMS

Microfinance is the provision of financial services to the poor and low-income people. From an earlier loan ceiling of $3,333, the BSP has raised it to $6,666 on microfinance loans under the new rules contained in BSP Circular 744 allowing some authorized banks to offer bigger loans to clients seeking to expand their businesses. These loans are generally unsecured and provided to households and microenterprises.

Despite relaxed regulations, noncollateralized microfinance loans offered by banks are expensive, with interest rates ranging from 2% to 4% per month (or 24% to 48% per annum). Some banks require collateral for microfinance loans. Philippine banks generally remain conservative despite liberalization of banking rules. In any case, the issue of collateral requirement can be addressed by the CSF program.

Table 7: Microfinance and Credit Surety Fund

Microfinance	Credit Surety Fund
Loan limit up to P300,000 ($6,666)	Amount of loan depends on the borrowers' capacity to pay and viability of the business.
Relatively higher market interest rates	Other banks (e.g., Development Bank of the Philippines) are putting a cap of 12% per annum on passed-on interest rates. Lending banks are encouraged to charge reasonable interest rates on surety-covered loans granted to micro, small, and medium-sized enterprises.
Higher costs (e.g., administrative, provisions for losses and funding)	Participating banks offer lower interest rates due to availability of Credit Surety Fund as collateral.
Limited to banks and financial institutions under Bangko Sentral ng Pilipinas	Cooperatives and nongovernment organizations are involved as conduits.

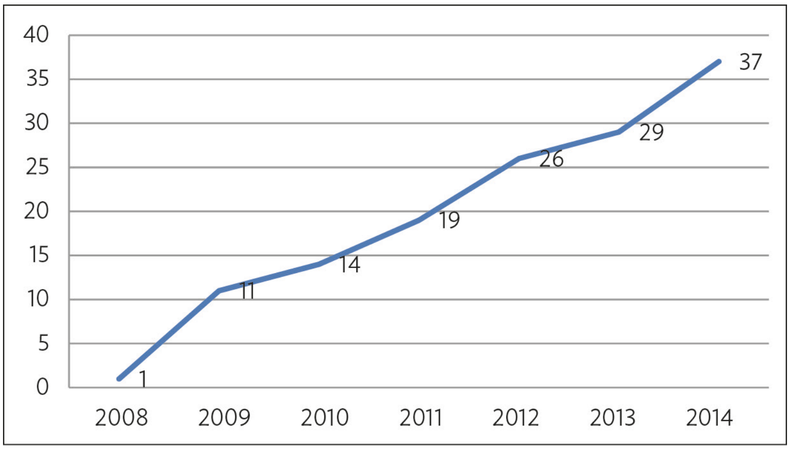
The CSF covers a wide spectrum of loans, from microfinance loans to wholesale loans to traditional lending by banks. By doing so, it can provide financing to the "missing middle"—enterprises whose needs are too large for microfinance and too small to obtain bank financing on their own.

Table 7 details how the CSF complements existing microfinance programs.

8. THE GROWING CSF COMMUNITY

Since its inception in 2008, the CSF program has expanded rapidly to 37 individual CSFs at the end of 2014 (Figure 2). They are spread throughout the country with 18 in the Luzon region, 7 in Visayas, and 12 in Mindanao. More were expected to be launched in 2015.

Figure 2: Number of Credit Surety Funds Established in the Philippines as of 31 December 2014



In terms of funding, the total trust fund pledges amounted to $12.88 million, of which $10.49 million had been fully paid by the partner organizations at the end of 2014 (Table 8).

Table 8: Summary of Cumulative Paid Contributions
($ millions)

Fund Contributors	2013	2014
Cooperatives and nongovernment organizations	2.89	3.77
Local government units	2.28	2.63
Land Bank of the Philippines	1.14	1.41
Development Bank of the Philippines	0.85	0.98
Industrial Guarantee and Loan Fund	1.47	1.70
Total	**8.63**	**10.49**

Source: Bangko Sentral ng Pilipinas, Department of Loans and Credit. 2015. CSF Annual Status Report as of 31 December 2014. Manila.

9. MSMES' ACCESS TO LOANS THROUGH THE CSF

From the inception of the program in 2008 to the end of 2014, total loans approved by banks under the CSF totaled $33.83 million, of which $27.78 million was released and supported access to finance by 14,434 borrowers (Table 9). These borrowers constitute a small portion of the nearly 941,000 MSMEs in the Philippines and one may draw the conclusion that the CSF is underutilized and ineffective in reaching MSMEs. However, the CSF is demand driven and available to registered MSMEs that are unable to obtain formal credit. Unfortunately, there are no reliable statistics on how many of these enterprises there are. Hence, it is difficult to know whether the demand of unbankable MSMEs is being met by the CSF.

Table 9: Credit Surety Fund Loans Comparative Summary
($ millions)

	Accumulated as of 2013	Accumulated as of 2014	Increase	
			Amount	**%**
Loans approved	23.74	33.83	10.09	42
Loans released	17.17	27.75	10.58	62

Accumulated loans outstanding as of as 2014 was $9.49 million, of which $7.75 million was covered by the CSF. The difference, about 18%, is the risk exposure of the banks. Based on CSF guidelines, the maximum amount of total loans that can be covered by the CSF is about $37.78 million. This is based on the lower amount calculated as either (i) 10 times the co-ops' paid-up contributions, which is currently $3.77 million (i.e., $37.78 million); or (ii) 5 times the CSF paid-up fund balance of $10.49 million (i.e., $52.44 million). Given that the outstanding loan balance now covered by surety is $9.49 million, the CSF could still cover additional loans totaling $28.22 million.

10. DIVERSE PROFILE OF MSME BENEFICIARIES

The CSF program does not focus on a particular industry or purpose, as long as the borrower is an MSME or a cooperative. This liberal policy allows the program to reach a wide and diverse range of borrowers.

Loans for production of agricultural and industrial goods account for 29% of the CSP portfolio. Loans for retail and wholesale trading and services account for 27%. The remainder and the bulk of approved loans, 44%, went to other activities including loans to cooperatives for relending and/or rediscounting to various microentrepreneurs.

MSME lending under the CSF can also be classified by industry following the Philippine Standard Industrial Classification. Cooperatives and NGOs involved in financial activities, such as microfinance, account for the largest single share of lending (28%), followed by loans to MSMEs engaged in agriculture (25%) and in retail trade (22%).

11. ADHERENCE TO QUALITY STANDARDS OF GUARANTEE SCHEMES

To assess the sustainability of the CSF, the BSP conducted an evaluation of the program's adherence to quality standards and best practices of other successful guarantee schemes. For the evaluation it used a manual published in 2012 by Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) titled *SMEs' Credit Guarantee Schemes in Developing and Emerging Markets* (Douette et al. 2012). The manual provides quality standards and guidance on how to set up and run a credit guarantee scheme for MSMEs. The manual was based on research of various guarantee schemes, in light of both positive and negative experiences.

11.1 Risk-Sharing Standard

Ideally, a guarantee scheme should provide for a risk sharing mechanism. A full guarantee can be an overly risky undertaking that puts extreme pressure on the trust fund. If the loan is unpaid, the lender (i.e., bank), under a full guarantee, does not bear any risk and would have no incentive to try to rescue the client or to initiate appropriate legal action. Further, the supervisory authority may find that the guarantor actually acts as a bank and is susceptible to creating a systemic risk, which would force the supervisory authority to apply more rigorous prudential rules, probably not different from those of financial institutions. The social goal of the instrument would vanish (Douette et al. 2012).

The CSF features a unique risk-sharing mechanism in which the lending bank and cooperatives share the risk. The CSF implements a basic risk-sharing ratio of 80% for CSF and 20% for the bank. For other schemes, the share guaranteed is generally above 50%, according to a World Bank study (Saadani et al. 2010). Therefore, the CSF cover rate of 80% is higher than some other guarantee schemes but the same as the standard indicated in the GIZ study.

Credit risk can also be transferred to the endorsing cooperative or NGO. Upon payment of a claim to the bank, the CSF may collect the same amount from the endorsing cooperative, thereby transferring credit risk. To mitigate the risk of noncollection, the CSF thoroughly screens the participating cooperatives, observing strict eligibility requirements as set out in the rules and regulations.

11.2 Adherence to Other Standards

The CSF program substantially complied with the other quality standards set out in the GIZ study. Examples are provided below.

Best practice requires that the guarantee should follow a stop-loss policy. CSF policy sets a borrowing limit of 10 times the cooperative’s contribution to the CSF and total outstanding loans cannot exceed 5 times the total fund. Further, the CSF must stop issuing surety cover when the total outstanding past due loans ratio exceeds 10%.

The CSF also has a credible loan evaluation process that is observed diligently by trained loan officers and managers. The scheme provides additional credit protection by requiring borrowers to assign their share capital in the cooperative. The CSF also has readily available equity capital that is sufficient to meet current and possible financial obligations. The CSF undertakes conservative financial investments and sound liquidity management with the funds invested in safe and income-yielding government securities. And finally, active participation of the private sector (i.e., cooperatives and NGOs) as contributors to the fund is important for the success of the CSF.

12. RISK MANAGEMENT

The CSF adopts risk management practices that take into account all relevant risks that can threaten its sustainability:

Credit Risk

The past due ratio at the end of 2014 increased slightly to 1.6% as compared with 0.6% the previous year. The past due ratio pertains to the past due loans claimed by the lending bank against the CSF over the total outstanding loan balance.

When all the claims are paid to the lending bank, there are no more past due loans and all the remaining outstanding loans are considered current. After payment, the CSF books a receivable from the endorsing or borrowing cooperatives, which are responsible for collecting defaulted loans from their member-borrowers. This counter guarantee mechanism and the relatively low past due ratio indicate low overall credit risk.

Risk Diversification

The CSF has a diversified risk structure based on a large number of borrowers, geographic and industry spread, and varying maturities. Its portfolio is made up of 14,434 MSME borrowers, each with a bite-sized exposure, and the fortunes of these borrowers are not closely tied to one another. Geographically, the CSF program is established in different provinces and cities spread across the country. Loans are spread across different industries and economic activities, as noted previously.

Maturity Risk

Longer-term loans are considered more risky than short-term loans. More generally, sound time diversification policy suggests that organizations should build portfolios not concentrated in particular maturities. For the CSF, 70% of the loans released are short-term with maturities of less than 1 year.

Liquidity Risk

This is the risk that the entity will not have sufficient funds available to pay creditors and other debts. The current ratio of funds to liabilities is favorable at 139% while solvency risk is adequate with normal leverage ratio at 115% in 2014. The higher current ratio indicates that that the CSF is liquid enough to pay creditors and other debts. Funds are invested in liquid short-term government securities.

Market Risk

Losses may arise from changes in market conditions. Interest rates are a key market risk in which the value of a fixed income security will fall as a result of an increase in market interest rates. The primary purpose of the CSF is to enable MSMEs and cooperatives to access bank loans. It is not primarily an investment vehicle designed to general income; it is a nonprofit public–private undertaking. Although funds are invested in safe, secure, and at the same time income-earning investment securities such as government bills and bonds, generally, the primary concern of the CSF is the liquidity of the fund to meet potential obligations.

Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed processes, people and systems, or external events. Breakdowns in internal control and corporate governance are the major causes of operational risk. In general, the Oversight Committee is responsible for the proper administration and management of the CSF. CSF policies should ensure that members of the Oversight Committee act competently, objectively, and independently in making important decisions affecting CSF operations.

Strategic Risk

Strategic risk is the level of certainty that an organization has adopted the right strategies to be successful and sustainable. The CSF risk management strategy is anchored on these four basic aspects: (i) avoid risk if necessary by choosing not to undertake some activities; (ii) transfer risk to other parties, such as cooperatives; (iii) mitigate risk through preventive and detective control measures; and (iv) accept risk, recognizing that undertaking certain risky activities can generate stakeholder value and achieve the purpose of the program.

13. INSTITUTIONAL PARTNERS AND STAKEHOLDERS

The CSF has benefited from the support of three key partners. The Land Bank of the Philippines is not only a donor but is also a lender to MSMEs and a trustee bank for local CSFs. It has been awarded with recognition as the Most Outstanding Program Partner and Outstanding Lending Bank for 2 years. A second partner is the Development Bank of the Philippines, which has been with the CSF program since it started in 2008. Apart from being a donor, it too has provided lending to MSMEs and trust fund services to local CSFs. Finally, the Industrial Guarantee and Loan Fund (IGLF) is another donor and has been very supportive in the implementation of capability enhancement training programs. Through the efforts and funding of the IGLF, many cooperatives and hundreds of MSMEs have benefited from the training programs.

14. CAPABILITY ENHANCEMENT PROGRAM

Aside from guaranteeing loans, CSF also delivers the Capability Enhancement Program, which consists of several training courses for cooperatives and MSMEs to improve their management. There are currently four main courses offered.

Credit Appraisal and Monitoring is a 6-day course aimed at enhancing the credit and risk management skills of cooperatives, particularly in evaluating loan proposals of their MSME members. The course is being implemented by the University of the Philippines Institute of Small-Scale Industries with funding by the IGLF.

Financial Management has 7 modules covering the basic competencies required from cooperative officers and MSMEs in managing their financial resources. It is also intended for the Oversight Committee members to develop their skills in risk management, internal controls, and audit. It replaced an earlier course, Appreciation of Financial Statements.

Entrepreneurship and Business Management is a short course intended to provide the target participants, particularly MSMEs and enterprising cooperatives, with the basic knowledge, skills, and competencies required of managers and business owners in engaging in entrepreneurial activities, developing business plans, and managing a business enterprise.

The Risk Management Seminar equips cooperatives and MSMEs with basic knowledge and skills in risk management. The Institute of Small-Scale Industries implements the seminar with funding from the IGLF. Interesting topics in risk management include concepts, challenges and opportunities, tools, and strategies. The participants are also required to apply the knowledge gained from the lecture in a guided workshop to create and present a risk management plan.

15. INSTITUTIONALIZATION OF THE CSF

For the past years, one of the most prevalent issues affecting the CSF has been the lack of legal personality, but this issue is now put to rest. On 6 February 2016, Republic Act 10744, otherwise known as the Credit Surety Fund Cooperative Act of 2015, earlier passed by the Philippine Congress took effect. With this new law, the CSF will not be just a mere program, but a duly recognized institution with separate juridical personality, fully supported by the Cooperative Development Authority, the BSP, Land Bank of the Philippines, Development Bank of the Philippines, Industrial Guarantee and Loan Fund, local government units, and other government agencies.

Under the new CSF law, the Cooperative Development Authority shall be in charge of registration, regulation, and supervision of all CSFs in the country. On the other hand, the BSP shall spearhead the promotion, encouragement, creation, and organizational development of CSF Cooperatives and facilitate the acquisition of technical assistance such as training and seminars in coordination with other public or private stakeholders.

Presently, a joint interagency CSF committee, composed of representatives from the Cooperative Development Authority, BSP, and the Department of Finance, has been formed to draft and promulgate the implementing rules and regulations of the CSF law.

16. ISSUES AND CHALLENGES

The CSF faces key challenges, which, if addressed, would enhance its operations.

Delayed Processing of Loan Applications

The processing of loan applications by banks, whether covered by the CSF or under regular lending windows, is slow. Lack of staff (i.e., loan officers), voluminous documentary requirements, and stringent procedures are the common reasons. A World Bank study revealed that the Philippines ranks third lowest worldwide, after Bangladesh and Pakistan, in terms of number of days to process SME loan applications. This highlights the inefficiencies of Philippine financial institutions, even with the presence of the CSF and other available guarantees (Beck et al. 2006).

Lack of Credit Information

Another challenge is the lack of reliable, high-quality, and cost-efficient credit information to evaluate loan proposals. Credit information is a key factor in assessing and managing risk. A credit bureau would be very helpful in providing information on MSMEs and is essential to creating an enabling environment for the sector (Bennett et al. 2005).

Other Efforts

The CSF can also be improved by strengthening certain key features. These include (i) expanding capability enhancement training and seminars to improve the capacity of banks and cooperatives in evaluating loan proposals; (ii) observing rigorous control measures through audit and monitoring activities to keep relevant risks to a minimum; (iii) improving loan processing procedures to decrease turnaround time without sacrificing prudent loan evaluation; (iv) conducting regular dialogues and meetings with program partners and stakeholders; and (v) undertaking promotional activities including business forums, symposiums, briefings, general assemblies, and press releases.

17. CONCLUSION

The CSF has been performing well and according to expectations. Targets used as performance standards have been achieved. The CSF is financially sound with related financial risks maintained at minimum and tolerable levels. The program also adheres to quality standards on established credit guarantee schemes in areas such as risk management, credit policies, liquidity management, and private sector participation.

However, the CSF still faces several limitations and challenges, including its legal status and limited funding. Because of these factors, the CSF has not been able to extend its reach to the great majority of unbankable MSMEs. The share of total bank lending flowing to micro and small enterprises has decreased consistently in recent years to 4.9% and is much lower than the required 8.0%. To improve performance, plans and strategies anchored in institutional change, aggressive promotional campaigns, and expanded capacity building activities for the stakeholders and borrowers are needed.

Nevertheless, the CSF program has provided support for MSMEs with a viable business plan to access formal credit without providing collateral. The much-needed credit provides them with an opportunity to grow, thus generating jobs and contributing to inclusive economic growth. MSMEs need to be competitive in these challenging times, especially with the advent of the much-anticipated ASEAN Economic Community.

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