



World Council of Credit Unions, Inc.

# **CREDIT UNION EMPOWERMENT AND STRENGTHENING (CUES), Philippines**

**A Cooperative Development Program Case Study**

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## **Table of Contents**

### **I. Executive Summary**

### **II. WOCCU's Traditional Credit Union Development**

### **III. Implementation of the Model Credit Union Methodology in the Philippines**

#### **A. Project Description and Setting**

- 1. Intended Beneficiaries**
- 2. Project Objectives**
- 3. Project Components**
- 4. Implementation Strategy**

#### **B. Project Implementation**

- 1. Project Management and Organization**
- 2. Project Reporting/Monitoring**
- 3. Implementation Problems/Issues**

#### **C. Impact of the Project**

### **IV. The Participating Credit Unions**

#### **A. Cooperative Organization and Governance**

#### **B. Leadership and Decision Making**

#### **C. Membership and Member Participation**

#### **D. Management**

#### **E. Transparency/Accountability**

#### **F. Financial Analysis**

#### **G. Outreach**

#### **H. Salience**

### **V. Analysis of Financial Performance**

#### **A. Financial Structure**

#### **B. Protection**

#### **C. Asset Quality**

#### **D. Growth**

### **VI: Lessons Learned from Philippines late 90s vs late 1980s**

### **VII: Unresolved issues in Credit Union Development**

#### **A. Legal and regulatory framework**

#### **B. New paradigms of credit union organization**

#### **C. Governance**

#### **D. Tools development**

### **Appendix 1: Financial Reports for Bansalan Cooperative Society**

### **Appendix 2: Financial Reports for "Batch 1" CUES Credit Unions**

### **Appendix 3: CUES Implementation Strategy**

### **Appendix 4: PEARLS Technical Guide**

### **Appendix 5: Overview of WOCCU's Model Law for Credit Unions**

### **Appendix 6: Savings Technical Guide**

## **I. Executive Summary**

WOCCU has supported credit union development in the Philippines for over 15 years. Despite 2 large USAID projects and well-intended missionary zeal the results in the Philippines in the late 1980s and early 1990s were less than impressive. Our lack of success forced WOCCU to rethink its development philosophy.

Our case study will focus on our cooperative development activities in the Philippines with specific emphasis on how our current Philippines model builds upon our lessons learned throughout the last 15 years. This time period demonstrates course corrections, recent successes, and also points out several as yet unresolved issues for tomorrow.

### **Early Philippines project**

Our early projects in the Philippines which were implemented in the mid - late 1980s were characterized by a traditional “trickle-down” approach and the assumption that credit unions’ purpose was to provide cheap loans to the poor. In this approach WOCCU spent time, effort, and money to support national associations with the belief that a strong national association would in turn transfer technical skills and sustainability principles to grassroots-level credit unions.

What we found instead in the Philippines and other countries was that creating a top-heavy organization with little “bottom-level” quality at the primary level was not dealing with the more fundamental credit union development issues. This focus on “charitable” lending was leading to insolvency and insecurity and a consequent lack of credibility and confidence among potential and former credit union members.

The problem of the early development models can be easily illustrated by comments such as these:

Indonesian seamstress: “The credit union is where I go for cheap loans. I only save as much as I need for the size loan I want. I put the majority of my savings in a bank where I know my savings are safe because they collect loans while the CU does not.”

Philippine CU: “Our purpose is to provide cheap loans to members. We aren’t too hard on borrowers about collection because they are poor. Filipinos are ‘loan-ly’ people.”

### **Change in Methodology**

The overall early 1990s result in the Philippines was sobering, and forced WOCCU to re-evaluate our development model. The fundamental switch in our philosophy might be summed up by saying that we went from a top-down, system-level, credit-lead approach to a bottom-up, savings-driven approach focused on individual credit union security and sustainability.

In the new “model credit union” methodology we recognize that:

1. Savings services (for personal asset accumulation) are as important if not more important than access to credit.

2. As financial intermediaries, it is essential that they be internally stable and solvent, able to protect member deposits, and not dependent on external credit.
3. Credit unions must be balanced between the needs of net-savers (safe and secure savings, liquidity, return) and net-borrowers (access to loans, non-usurious rates).
4. Credit unions must act as financial intermediaries, not multi-purpose coops requiring different technical expertise.

This change is reflected in the PEARLS monitoring system, designed to help provide objective measures of credit union performance.

As the model credit union methodology was implemented in the Philippines beginning in 1998, concrete changes could be observed in credit union quality.

The table below shows that from 1998-2002, credit unions in the WOCCU/Philippines Credit Union Empowering and Strengthening project went from technical insolvency to profitability, positive asset growth, and restructured balance sheets while greatly increasing scale and outreach.

Philippines (Batch 1)*	12/31/98	12/31/02
Credit Unions	11	11
Membership	28,692	125,750
Delinquency (PAR)	63.00%	7.05%
Loan Loss Provisions (>12 mos; 1-12	9.20% + 0%	100% + >35%
Savings/Assets	35.11%	57.66%
Loans/Assets	60.23%	66.84%
Asset Growth vs. Inflation	8% < 10.57%	38.46% > 2.6%
Savings	\$4.3 million	\$14.2 million
Avg. Savings & Shares	\$289	\$151

\* Batch 1 refer to the original 11 CUES credit unions which have participated in the entire transformation process from beginning to end and thus provide a more realistic basis for comparison. Batch 2 credit unions are still in the transformation process.

From year-end 1998 to year-end 2002, Batch 1 CUES credit unions more than quadrupled outreach from 28,692 to 125,750 members. Delinquency which had exceeded 60% in 1998 was brought under relative control to 7.05% by year-end 2002 following the adoption of financial disciplines including loan loss provisioning, write-offs of loans delinquent more than 12 months,

rigorous collection, and better credit analysis. CUES credit unions went from minimal provision for loan losses (just under 10% for loans delinquent more than 12 months and nothing for loans delinquent less than 12 months) to full provisioning per WOCCU international standards (100% for loans delinquent more than 12 months and 35% for loans delinquent 1-12 months). The savings-to-assets and loans-to-assets ratios show positive changes in the financial structure of CUES credit unions' balance sheets. Savings relative to assets increased from 35% to 57%, replacing shares as the dominant source of funds for financing loans. Loans have increased from 60% to 67% of total assets showing that CUES credit unions are investing more in loans to members than non-earning assets such as buildings. Whereas in 1998 CUES credit unions were shrinking in asset growth relative to inflation (8% versus 10.57% inflation), by year-end 2002, the same credit unions' assets were growing 10 times more than inflation (38.46% versus 2.6%). Finally, using average savings and shares as a proxy for household wealth, the table shows that while outreach quadrupled and total savings increased from \$4.3 million to \$14.2 million, average savings and shares per member decreased from \$289 to \$151 per member, indicating that these credit unions are not only reached more people but also much poorer members than they were serving in 1998.

This case study will highlight both the viability of the cooperative finance model and the ability of targeted development support to produce real bottom-line results for the local population.

We will also examine lessons learned within the Philippines that we have exported to other regions, as well as the way in which previous successes and missteps in the Philippines and other regions inform our current interventions there.

#### **Unresolved issues:**

While the majority of the case study will deal with the evolution of our development approach, it is also clear that (as in any development model) there are ongoing unresolved issues that will be the focus of our efforts in the future. The case study will point out where we perceive the most important next steps in the process. Some of these issues include:

- Continued improvement of tools for credit unions.
- Ways to deal effectively with governance issues.
- Competitiveness – system integration
- Regulatory framework
- Improved system-level capacity

## II. Background: WOCCU's Traditional Credit Union Development Strategy (1970-1990)

The World Council of Credit Unions is an organization dedicated to the strengthening of credit unions and credit union movements as a way of providing financial services to the poor around the world. While our core mission to extend cooperative financial services to people who want and need them has not changed over the years, the strategy we have used to achieve our goals has.

From the 1970's through the early 1990's WOCCU pursued this goal through a strategy that was focused on support of national-level credit union organizations and what has become known as the traditional credit union model.

The credit union movement is organized around national-level political organizations that agglomerate individual credit union institutions under it. These national-level organizations, while unique in each country, generally serve the purpose of supporting individual member credit unions through the provision of technical services, training, and often act as a central financing facility. In some countries they also act as the primary regulatory body.

Because of this strong central role that the national-level organizations play, and given WOCCU's role as the apex organization of the worldwide credit union movement and its relationship with these organizations, WOCCU targeted them as the object of development efforts.

Our strategy through this period was typified by a focus on strengthening the ability of national-level organizations to provide services, training, and support to their member organizations. It was our belief that by improving their capacity we would be providing the means to improving credit unions and providing improved services to their members.

### **The traditional strategy in action – the Philippines.**

The Philippines provides a clear example of the implementation of this strategy and the problems associated with it.

In 1988 WOCCU began a project in the Philippines which sought to overcome several specific, identified problems within the credit union movement there:

- **Market penetration and fragmentation.** In a population of 60 million, membership in credit unions affiliated with the principal country-level organization, PFCCO, was only 50,000 while approximately half of the nation's 1,500 registered credit unions were inactive. An additional 250 credit unions remained unaffiliated with any national-level organization.
- **Poor credit cooperative financial management.** While some credit unions were using sophisticated accounting systems and had solid financial management practices the more typical situation was financial underperformance due to poor financial management leading to loan delinquency problems, inability to mobilize capital and savings, and insolvency.
- **Inability to respond to demand for credit.** There was an estimated unmet demand for productive lending of US\$ 10 million. PFCCO's Central Finance Facility was capitalized at only \$US 75,000.
- **PFCCO's lack of financial sustainability.** Simply stated, PFCCO was underfinanced, and thus unable to provide needed assistance to the primary level of cooperatives.

These problems were fairly typical of the types of problems in credit union movements in other parts of the world. In most significant ways, these problems (lack of market penetration, poor financial management, inability to respond to credit demand) continue to be some of the main problems in credit union movements today.

The strategy that we tried in the Philippines was typical of the strategy used elsewhere during that time period.

The strategy that was envisioned to deal with these problems was essentially a multi-faceted program of PFCCO (national association) strengthening, including a strong emphasis on the availability of credit even if that required outside capital.

Market development and consolidation, financial management systems development, credit expansion, and financial sustainability were the primary goals of the project.

The key point to note, however, was that all of these objectives were to be achieved via support of the PFCCO itself and an obsession with cheap credit rather than working directly with credit unions on a self-sustainable basis that stressed the safety of member deposits.

The fundamental assumptions of the WOCCU development model in the 70s and 80 was that the best way to improve individual credit union performance was to improve the skills and capacities of their national level organization and that the expansion of credit using savings or external was the panacea for addressing poverty. However, these fundamental assumptions turned out to be wrong.

Simply put, supporting national association infrastructure and overhead without concrete deliverables and accountability at the grass-roots credit union level created perverse incentives such as rent-seeking behavior at the national level. This meant that putting money, time, and effort into these organizations did not create efficient national-level organizations, nor, most importantly, did it create strong and sustainable member credit unions.

External funds for lending simply increased the dependency of credit unions on external funding sources and produced an imbalance towards accessible, cheap credit to the detriment of savings mobilization. These sobering results from early 1990s result in the Philippines forced WOCCU to re-evaluate our conceptual framework, making a distinction between the "traditional credit union model" and the "new credit union model." The following table summarizes the differences between the traditional credit unions and new model credit unions in the areas of ideology, financial structure, interest rates, credit administration, and financial disciplines, human resources, and physical image.

"Traditional" Credit Unions	New Model Credit Unions
<b>Ideology</b>	
heavily focused on cheap loans as method of alleviating poverty membership is economically and geographically homogeneous membership is frequently oriented towards receiving a loan products are heavily credit oriented, savings often not withdrawable poor or outdated internal controls and bylaws.	a business orientation to assure that social objectives are sustainable members come from diverse backgrounds member's reason for joining is to for safe and accessible savings as well as loans principal services to members include both savings and credit by-laws are updated to reflect current realities
<b>Financial Structure</b>	
source of funds is non-withdrawable members savings and/or external credit high percentage of non-earning assets	source of funds is withdrawable member savings/deposits minimal investment in non-earning assets
<b>Interest Rates</b>	
interest rates for loans are below market and subsidized by savers savings, if available, are at negative real rates and erode value shares are at a below inflation and below market rates	loans made at rates which cover ALL costs plus a reasonable margin savings deposits are maintained at real rates of return which preserve real value shares (risk capital) is at least equal to inflation and more than savings
<b>Credit Administration</b>	
loan analysis based on a multiple of shares (share-leveraging) which does not reflect capacity to repay loan sizes are based on social rather than business decisions collateral is often symbolic and not easy to convert to cash	loan analysis is based on repayment capacity loan size is determined by capital requirements, risk exposure, cash flow loan collateral is legally binding and convertible to cash
<b>Financial Disciplines</b>	
delinquency is measured by arrears/loan portfolio (under-reporting) no or inadequate loan loss provisioning loans are written off infrequently distorting balance sheet (overstating assets) insufficient liquidity to meet withdrawal demand insufficient risk management methods putting equity at risk high levels of non-earning assets earnings distributed as dividends without retaining for adequate institutional capital reserves accounting is frequently far behind relaxed attitudes towards business planning and growth no objective system for measuring performance	delinquency is measured based on total outstanding loan balance/loan portfolio (accurate reporting) loan loss provision is based on 100% of all loans delinquent more than one year loan write-offs for all loans delinquent more than one year liquidity reserves are 10% to 25% of savings deposits risk management includes expanded coverage of all assets non-earning assets are less than or equal to 5% of total assets earnings retained to meet 10% or more net institutional capital reserves target accounting is balanced and timely planning and budgeting includes aggressive goal setting performance indicators are based on the PEARLS system
<b>Human Resources</b>	
board is oriented toward borrowers confusion over board versus management roles (Board often inappropriately involved in managerial responsibilities) reliance on volunteers for professional responsibilities and/or employees are not financial professionals salaries are not competitive and do not attract qualified applicants	directors are business and service oriented attuned to savers as well as borrowers clear separation of board and management roles (Board focuses on setting policies and making Management accountable for implementation) employees are qualified professionals salaries are competitive with other local financial services providers
<b>Physical Image</b>	
credit cooperatives located in inaccessible non-business facilities and settings poorly equipped and low-efficiency operations	the credit cooperative has accessible and appropriate business premises public areas of the cooperative are comfortable, well-lit and efficient

### **III. Implementation of the Model Credit Union Methodology in the Philippines**

#### **A. Project Description and Setting**

The Credit Union Empowerment and Strengthening project (CUES), started in 1997 and continuing through the present is a project dedicated to providing high-quality, sustainable financial services to the poor of the Southern Mindanao region of the Philippines. Recently there has been an expansion into the Autonomous Regions of Muslim Mindanao (ARMM) and other conflict areas as opportunities arise.

The goal of the project is not to create new cooperative organizations, but rather to “rebuild” them through the process of Model Credit Union Building. This is also complimented by the Savings and Credit with Education strategy a group lending product targeted at very poor segments of the population.

As described in the previous section, cooperatives in the Philippines have historically viewed themselves as social institutions providing cheap loans and a variety of non-financial services to members. Cooperatives participating in the WOCCU/Philippines CUES program have abandoned this traditional view in favor of a self-image as transparent institutions focused on financial intermediation and operated on an entrepreneurial business basis offering members safe and accessible savings products as well as competitively priced loans.

This project has two main components:

- a. Model Credit Union Building (MCUB) shifts the priorities of credit cooperatives from social issues to business discipline. This is accomplished through education, technical skills transfer, incentives and performance-based contracts between the project and the participating cooperatives. Twelve model cooperatives were initially chosen in the vicinity of Davao and Tagum, and another seven have been added to the program to receive technical assistance under the program.
- b. Savings and Credit With Education (SCWE) is a group loan and savings product developed by WOCCU with Freedom From Hunger. SCWE’s two tightly integrated components, savings/credit and education provide financial services to women in underdeveloped urban and rural areas and education on basic health, nutrition; microenterprise development; and Credit Association management.

#### **1. Intended Beneficiaries**

The original CUES cooperatives are divided between six rural and six urban areas. Of the over 173,000 members currently served by the Batch 1 CUES cooperatives, an estimated 70-80% are self-employed. The remaining 20%-30% of members are salaried employees.

Common sources of primary and supplemental income include farming, sari-sari stores, market trading, food stall, family restaurants, and seamstress shops.

The typical cooperative member earns a monthly income of US\$100. For the SCWE product, CUES deliberately selects communities where neither formal banking services nor NGO-sponsored credit programs are available.

## 2. Project Objectives

- 1) Improve the financial, policy and operational components of credit cooperatives so they will better deliver effective financial services to members and Savings and Credit Associations.
- 2) Increase outreach by integrating a Savings and Credit with Education (village banking and non-formal adult education) services to women with savings, loans and educational services.
- 3) Increase savings mobilization through institutional strengthening, image building, market pricing, product innovation, and enhanced marketing efforts.
- 4) Expand and improve microenterprise lending activities to members and Savings and Credit Associations through use of new products, underwriting standards, and loan terms.
- 5) Enhance sustainability through improved profits and the adoption of financial and business disciplines through an internationally recognized program called “Model Credit Union Building” program.

## 3. Project Components

**MCUB methodology:** Model Credit Union Building transforms cooperatives into “model credit unions,” adhering to strict prudential standards and financial disciplines, which translate into safety and soundness and ultimately, the protection of members’ assets. This methodology forms the core of WOCCU’s current credit union development model. This methodology is described in much more depth in Section 4, Lessons Learned.

**SCWE:** SCWE (Savings and Credit with Education) is a variant of the Credit with Education methodology and has been developed and implemented in collaboration with Freedom from Hunger. The group lending methodology is highly effective as a means of providing credit to very low income families. The method provides loans to the group and each member of the group guarantees the loan of the others in the group. This method reduces loan losses and provides a path for low income borrowers to graduate to individual loans. WOCCU introduced both non-mandatory borrowing and non-mandatory savings. There is also an educational component, administered by Freedom for Hunger, which provides additional skills training to the groups.

## 4. Implementation Strategy

The implementation strategy began with a very clear set of participation criteria that were used to qualify potential credit union partners. CUES-Philippines staff conducted institutional assessments. These assessments were made with the goal of selecting the credit unions with the best potential of successfully implementing the Model Credit Union methodology. Given the potential strain on credit union resources from SCWE, only the strongest credit unions were

allowed to offer SCWE.

Business and marketing plans were then developed for each credit union. The CUES-Philippines program office also provided technical assistance to the model credit cooperative candidates on member survey design, distribution, compilation & analysis. The purpose of the surveys was to help determine members' service preferences and to design appropriate products directed at micro-entrepreneurship.

With respect to SCWE, field agents were hired and trained, credit cooperative personnel were trained, and women's groups were formed.

The Model Credit Union Building methodology has a clear set of goals and procedures and the implementation of this model was coordinated and supervised by the Program Office.

More information about the implementation strategy can be found in Appendix 3.

## **B. Project Implementation**

### **1. Project Management and Organization**

In order to administer the CUES program WOCCU has established a Program Office located in Mindanao.

The CUES-Philippines Program Office has three main responsibilities:

- 1) In its role as a primary actor and implementer of the CUES-Philippines Program, it carries out the strengthening and empowerment of participating credit cooperatives through the Model Credit Union Building Program component to include the key areas defined in the elements of a model credit cooperative and the Savings and Credit with Education program activities; and
- 2) In its role as development facilitator for the credit cooperatives, it manages the development and completion of all credit cooperatives training activities, especially on-site technical assistance.
- 3) In its role as prime contractor for program implementation, CUES-Philippines ensures that credit cooperatives are following the required provisions for non-U.S. non-governmental grantees.

Consequently the CUES-Philippines program office:

- 1) Implements a work plan to effect the transfer of skills and information to the participating cooperatives in order to help achieve their transformation into model credit cooperatives and to facilitate the successful conduct of the Savings and Credit with Education program. This includes establishing model guidelines, policies, disciplines, tools, and financial ratios; establishing a schedule of field visits to follow-up on program related

training; participating in the development of credit cooperative business plans, financial goals, operating budgets and performance evaluations; and developing financial and performance information reporting requirements.

- 2) Takes part in the credit cooperatives' annual self-evaluation of the goals achieved and activities completed during the previous year, and compares the projected and actual results. Prepares a report on the findings and submits them to the credit cooperative.
- 3) Takes part in evaluations of participating cooperatives and determines whether to continue or terminate participation agreements with individual credit cooperatives.
- 4) Creates teams among existing CUES-Philippines program staff to obtain results at participating credit cooperatives. The team serves as advisor/facilitator to the management and leadership with regard to successfully implementing the CUES-Philippines Program.
- 5) Ensures full confidentiality of all financial and statistical information obtained from the credit cooperative.
- 6) Reviews with the credit cooperative any suggested use of the development grant to ensure its compliance. If it is found that applicable standard provisions were violated, CUES-Philippines notifies the credit cooperative in writing

SCWE builds relationships with poor women in remote areas. The partner cooperatives participating in the WOCCU-Philippines project select and hire a key representative from each village. Called field agents, these women receive training on basic personal finance and health issues: how to save, how to start, run and grow a small business, as well as information on nutrition, infant care and childcare.

After training, the field agents go back to their communities and organize small solidarity groups of five to six women who meet weekly to receive training on the same topics. As part of their function, field agents also help their groups collect and pool savings weekly. Once enough solidarity groups are formed and the process of saving begins, four to six solidarity groups form a savings and credit association (SCA), which becomes responsible for granting loans and collecting savings deposits and loan payments. The solidarity groups assume joint liability for each woman's individual loan. Each savings and credit association maintains an account at a local cooperative, which also provides capital for their credit needs. Once an SCA participant is able to save the minimum amount for a credit union share account and has demonstrated the responsible use of credit, she is eligible to graduate from the SCWE program and become a direct member of the cooperative.

## **2. Project Reporting/Monitoring**

The key tool that WOCCU uses for project reporting and monitoring is the PEARLS Monitoring System. PEARLS refers to Protection, Effective financial structure, Asset quality, Rates of return and costs, Liquidity, and Signs of growth.

Monitoring is done via comparison with specific benchmarks for each credit union that were established at the start of the project. Participating credit unions report on a monthly schedule. Reports are monitored both by the CUES-Philippines Program Office and staff at the home

office of WOCCU in Madison, Wisconsin.

PEARLS is an internationally recognized method of measuring key operational areas and thereby the financial health of a credit union. PEARLS is an acronym for protection, effective financial structure, asset quality, rates of return and costs, liquidity and signs of growth. With the PEARLS Monitoring System, the Philippines cooperatives can identify and self-monitor the indicators that affect their fiscal health and the ability to provide sustainable services to members.

PEARLS helps managers find meaningful solutions to serious institutional deficiencies. For example, the PEARLS system is capable of identifying a credit union with a weak capital base, and can also identify the probable causes (e.g., insufficient gross income, excessive operating expenses, or high delinquency losses).

Use of the system permits managers to quickly and accurately pinpoint troubled areas, and to make the necessary adjustments before problems become serious. In essence, PEARLS is an "early warning system" that generates invaluable management information.

One particularly important aspect of the PEARLS comparative rankings is its objectivity. No qualitative or subjective indicators are included in the rankings. By avoiding subjective assessments, it is possible to present objective reports to the credit unions that are substantiated by financial information taken from their balance sheets. The objective ranking system permits open discussion of problems with Boards of Directors and management. It is particularly useful in situations where a credit union is at the bottom of the ranking scale.

In addition to its usefulness as a management tool, the PEARLS system provides the framework for a supervisory unit at the National Federation. National Associations can use the financial ratios generated by PEARLS to conduct quarterly or monthly analyses of all key areas of credit union operations. These evaluations are invaluable for spotting trends and detecting areas of concern among the affiliates. With the standardization of the key financial ratios, all interested parties are looking at the same thing--what is important to the examiner is also important to the credit union manager.

**WOCCU INTERNATIONAL CREDIT UNION PRUDENTIAL STANDARDS OF EXCELLENCE (2003)**

<b>P-E-A-R-L-S RATIOS</b>		<b>GOALS</b>
<b>P</b>	<b><u>PROTECTION</u></b>	-
	1. Allowance for Loan Losses / Delinq. >12 Mo.	100%
	2. Net Allowance for Loan Losses / Delinq. 1-12 Mo.	35%
	3. Complete Loan Charge-Off of Delinquency > 12 Mo.	Yes or No
	4. Annual Loan Charge-offs / Average Loan Portfolio	0%
	5. Accum. Charge-Offs Recovered/ Accum Charge-Offs	100%

6.	Solvency	100%
7.	Allowance for Investments at Risk / Investments at Risk	110%

<b>E</b>	<b><u>EFFECTIVE FINANCIAL STRUCTURE</u></b>	
1.	Net Loans / Total Assets	Between 70 - 80%
2.	Liquid Assets / Total Assets	Max 20%
3.	Financial Investments / Total Assets	Max 10%
4.	Non-Financial Investments / Total Assets	0%
5.	Savings Deposits / Total Assets	Between 70 - 80%
6.	External Credit / Total Assets	0 - 5%
7.	Member Share Capital / Total Assets	Max 20%
8.	Institutional Capital / Total Assets	Min 10%
9.	Net Capital / Total Assets	Min 10%

<b>A</b>	<b><u>ASSET QUALITY</u></b>	
1.	Total Delinquency / Total Loan Portfolio	Less Than 5%
2.	Non-Earning Assets / Total Assets	Less Than 7%
3.	Zero Cost Funds / Non-earning. Assets	Greater Than or Equal to 100%

<b>R</b>	<b><u>RATES OF RETURN AND COSTS</u></b>	
1.	Net Loan Income / Average Net Loan Portfolio	Entrepreneurial Rate
2.	Liquid Assets Income / Avg. Liquid Assets	Market Rates
3.	Fin. Investment Income / Avg. Fin. Investments	Market Rates
4.	Non-Fin. Inv. Income / Avg. Non-Fin. Investments	Greater Than or Equal to R1
5.	Fin Costs: Savings Deposits / Avg. Savings Deposits	Market Rates
6.	Fin Costs: External Credit / Avg. External Credit	Less Than or Equal to R5
7.	Fin Costs: Member Shares / Avg. Member Shares	Greater Than or Equal to R5
8.	Gross Margin / Average Assets	Cover R9, R10 Increase Capital
9.	Operating Expenses / Average Assets	Between 3 - 10%
10.	Provisions for Risk Assets / Average Assets	Sufficient for Estimated Losses
11.	Other Income or Expense / Average Assets	Minimum
12.	Net Income / Average Assets	Enough to reach the goal for E8

<b>L</b>	<b><u>LIQUIDITY</u></b>	
1.	Liquid Assets - ST Payables / Total Deposits	Minimum 15%
2.	Liquidity Reserves / Total Savings Deposits	10%

	3. Non-Earning Liquid Assets / Total Assets	Less Than 1%
<b>S</b>	<b><u>SIGNS OF GROWTH (Annual Growth Rates)</u></b>	
	1. Loans	Sufficient to achieve goal in E1
	2. Liquid Assets	Sufficient to achieve goal in E2
	3. Financial Investments	Sufficient to achieve goal in E3
	4. Non-Financial Investments	Sufficient to achieve goal in E4
	5. Savings Deposits	Sufficient to achieve goal in E5
	6. External Credit	Sufficient to achieve goal in E5
	7. Share Capital	Sufficient to achieve goal in E7
	8. Institutional Capital	Sufficient to achieve goal on E8
	9. Net Capital	Sufficient to achieve goal on E9
	10. Membership	Minimum 5%
	11. Total Assets	More than Inflation

More information on PEARLS can be found in Appendix 4, the PEARLS Technical Guide.

**3. Implementation Problems/Issues** (including issues related to the operating environment, level playing field vis-à-vis other businesses, cooperative law, etc.)

The 2003 operating environment within the Philippines is relatively friendly to the credit unions, but could be much improved. The Philippines has had cooperative activity for many years. The majority of the cooperatives were founded more than 25 years ago and the PFCCO network was founded in the early 1970s.

The Cooperative Code of the Philippines (1990) provides the legal basis for all cooperatives including credit unions; activities including financial intermediation services. The government agency responsible for all cooperatives in the Philippines, is the Cooperative Development Authority (CDA).

The problem with the Cooperative Code is that it lacks provisions specific to the safe and sound management of cooperative financial intermediaries. Gaps in the code put credit union member savings at risk. Furthermore, the CDE which “supervises” all cooperative structures including

housing, agriculture, marketing, production, etc. lacks the specialized technical knowledge necessary to supervise financial institutions.

In terms of competitive environment, the CUES credit unions face intense competition.

### **C. Impact of the Project**

As a direct result of CUES, at the end of June 2003, there were more than 265,000 members (Batch 1 and Batch 2), two-thirds of whom are women. The members have saved US\$32 million and of the over 150,000 loans totaling US\$24.44 million, 70% are to women in the form of individual and group loans. The beneficiaries are evenly divided between urban and rural. Of these members, approximately 70-80% are self-employed. The remaining members are salaried employees, many of whom seek supplemental income to meet household needs.

Another aspect of the project which was very important and will be replicated is the interrelationship between the CUES program and other programs around the world. WOCCU technical assistance has included organizing best practice exchanges with the Calpia and CRECER in El Salvador and FENACOAC credit unions in Guatemala.

While WOCCU/Philippines CUES has benefited from best practices and best principle experiences in WOCCU programs in Guatemala (financial disciplines), El Salvador (marketing), Nicaragua (delinquency control, savings mobilization) and Ecuador (credit analysis), the Philippines program has, in turn, been able to share its innovations and tested tools with programs in Latin America, Central Europe, and Central Asia. This cross-regional learning and exchange has been possible largely due to USAID's Cooperative Development Program.

Model credit union building, SCWE, and the best practice exchanges have had the combined effect of instituting comprehensive financial disciplines, revolutionizing credit union operations, stimulating growth, and increasing outreach in partner cooperatives to achieve the single most important reform in the 30-year history of the Filipino credit unions.

#### **IV. The Participating Credit Unions**

At start-up the CUES program included a total of 12 credit unions. This number has steadily increased as new areas have been added, particularly in the Autonomous Regions of Muslim Mindanao (ARMM) . Each of these cooperatives has a distinct history and background and while they share similar characteristics, they do have some differences.

For the purposes of this case study, we will concentrate on the Bansalan credit union which is typical of the other CUES credit unions.

##### **A. Cooperative Organization and Governance**

Bansalan Cooperative Society (BCS) is a church inspired cooperative, organized and registered under the Cooperative Administration Office (CAO) in 1967. It renewed its registration as a bonafide cooperative with the Bureau of Cooperative development (BACOD) in 1978 and with Cooperative Development Authority (CDA) in 1991.

BCS operates within Bansalan, a municipality of Davao del Sur composed of 25 barangays in Southern Mindanao. Its office is very accessible to the members as it is located in Bansalan Public Market where public utility vehicles (jeeps, tricycles and motorcycles) are available most hours of the day. It can be reached through a radio network which also has an office in Davao City.

##### **B. Leadership and Decision Making**

**General Assembly** – The general assembly is composed of members who are entitled to vote under the articles of cooperation and bylaws. It is the highest policy making body and exercises exclusive powers as (a) determine and approve amendments to the articles and bylaws, (b) elect or appoint the members of the board and to remove them for cause and (c) approve the development plans of the cooperative, and all other powers defined in the Cooperative Code, articles and bylaws.

The General Assembly meets once a year, within 90 days after the closing of each fiscal year, however, a special assembly can be called provided a majority of the members of the Board agree.

**Board of Directors/Committees** – The Board of Directors is elected by the General Assembly and serves for 2 years each term for a maximum of 3 terms. The Board is responsible for the proper conduct and management of the affairs of the cooperative, directs and supervises the business by hiring and supervising the General Manager. The creation, termination, duties, and functions of the committees, are as outlined in the bylaws and policies of BCS.

The BCS Board has 7 members and there are 3 committees each composed of 3 members: the credit committee, the election committee, and the supervisory, audit, and inventory committee.

##### **C. Membership and Member Participation**

BCS has two types of members: (a) regular members who are entitled to all the rights and privileges of membership and (b) the associate members who do not have voting powers and are entitled only to such rights as stipulated in the bylaws.

Regular membership is open to any person who is a citizen of the Philippines, resides in the area of operations, and at least 15 years of age, with the capacity to contract, willing to take responsibilities of being member and has satisfied the minimum requirements for membership. School children however, are accepted as associate members through their respective school cooperatives. Minimum requirements for membership include (a) accomplished application form, (b) pre-membership seminar, (c) membership fee of 25 pesos (\$0.50us) and (d) initial share capital 530 pesos (\$10us).

#### **D. Management**

The manager, appointed by the Board, executes all policies adopted by the Board and supervises the day to day operation of the cooperative. The manager is supported by the accounting, merchandising, marketing and credit and collection units. The manager is supported by 10 skilled, full-time staff and two part time staff members.

#### **E. Transparency/Accountability**

Financial discipline, transparency and accountability are greatly assisted through the use of the PEARLS monitoring system. PEARLS reports are generated on a monthly basis. These reports give a clear picture of the financial health of the organization from a myriad of perspectives, allowing the project managers, the general assembly, and other external actors to clearly gauge the reality of performance through an objective, standardized system with a common nomenclature.

#### **F. Financial Analysis**

Please see Section 6, Analysis of Financial Performance.

#### **G. Outreach**

The credit unions participating in the CUES project have a very direct and important impact on the population and business environment of the regions that they serve.

By the end of June 2003, Batch 1 and Batch 2 credit unions had extended over 150,000 loans totaling US\$24.44 million. The total membership has reached more than 265,000 and these members have saved US\$32 million. Loan recipients are evenly divided between urban and rural. Membership is diverse with two-thirds being women and approximately 70-80% of members are self-employed. The remaining members are salaried employees, many of whom seek supplemental income to meet household needs.

Model credit union building, SCWE, and the best practice exchanges have had the combined effect of instituting comprehensive financial disciplines, revolutionizing credit union operations, stimulating growth, and increasing outreach in partner cooperatives to achieve the single most important reform in the 30-year of the Filipino credit unions.

Susan Bangalao is an individual who became involved with Panabo Multi-Purpose Cooperative. A few years prior to participating in the SCWE program, she attempted to start her cake baking and decorating business. Unfortunately, though, this first attempt failed because she faced numerous difficulties, including a lack of initial investment capital. After receiving formal training through the SCWE program in 1998, she took out a loan for 1,500 Philippine pesos (US\$35), which she used as start-up capital. Bangalao bought baking ingredients and supplies with succeeding loans. When the business became profitable, she started construction of a house for her family. Today, her house includes an expanded kitchen for the business. Bangalao's earnings doubled over time. Today, her cakes sell from P100 to P8,000 (US\$2 to \$153) with varying designs for different occasions and clientele. She's now catering citywide and is highly recommended throughout her community.

Bangalao explains, "The financial education offered through SCWE has been the most important benefit to me. I recognized the need to be educated and the importance of balancing life between business and family."

"Filipino women must contribute to the family income," she states emphatically. "My credit union has helped me to create a better way of life for my family." Bangalao loves her work and the independence that being a businesswoman and a credit union member have given her. Once she graduates from the SCWE program, she plans to become a regular, direct member of Panabo Multi-Purpose Cooperative so that she can gain access to even more financial services to further her business and continue improving her family's life. She takes great pride in being a homemaker, a wife, a mother and a businesswoman. Through her own initiative and the support of the credit union, Susan Bangalao is re-educated and successful.

As this example shows, the credit unions provide great support for individuals as well as providing support for small scale productive activities that have an impact on the local economy.

However, while Ms. Bangalao's example shows the full impact of credit unions on productive industry, it is also important to note that savings mobilizations continues to be one of the most important services available to poor families. Safe and secure savings products allow families to mitigate the fluctuations characteristic of poor families.

## **H. Salience**

The impact that the CUES program has had on the region and on the financial sector can be measured in several ways.

The CUES program is serving the needs of a growing number of residents of Mindanao. At this time CUES credit unions (Batch 1 and Batch 2) have a membership of over 265,000. This has a direct impact in the lives of over 1 million Filipinos, more than 5% of the population of the island of Mindanao where the project is located.

While members of the CUES credit unions and their families are the direct beneficiaries of this project, many other residents of the Philippines are being positively affected through the way the project is influencing other institutions.

The success of the CUES credit unions has provided positive pressure on other credit unions that are now starting refine their own policies and adopt some of the CUES best practices. CUES credit unions tend to be much larger in average membership than other credit unions in the region. They are more efficient, can reach more people, and can take advantage of economies of scale. Unlike many traditional credit unions and microfinance organizations, CUES credit unions mobilize enough savings to allow independence from external sources of credit. As credit unions begin to adopt CUES-style innovations they move towards greater self-sustainability and the number of people that benefit indirectly from CUES is greatly expanded.

Even non-credit union organizations are adopting CUES-lead innovations. An example of this process is the USAID-supported Microenterprise Access to Banking Services (MABS) Program which has followed methodologies and examples set by CUES in their work with rural banks.

The PEARLS monitoring system, which is central to the Model Credit Union method, has been reviewed and adopted (with modifications) by several groups – including NATCO (the National Credit Union Association) and the Credit Policy Improvement Program. These groups have acknowledged the value of PEARLS and adopted similar systems to the benefit of their constituencies.

The success of CUES credit unions has also motivated government officials to cite it as an example of good financial management. Several government agencies, including the Central Bank, the PDIC (Philippine Deposit Insurance Corporation), the Land Bank, and the Cooperative Development Authority have specifically endorsed CUES and the Model Credit Union Methodology as a good model for all financial institutions.

Finally, the success of CUES has given positive incentives for legislators in the Philippines. Different groups, including Philippine congressmen, have now recognized the inadequacy of existing regulatory legislation and are currently pushing for improved laws.

These many different levels of impact and influence have meant that the CUES project has had a profound, positive impact on both the people of Mindanao and on the regions financial sector.

## V. Analysis of Financial Performance

In the Philippines, the adoption of Model Credit Union standards and methods of operation has helped the cooperatives become competitive in the market place, financially independent and secure in their capitalization.

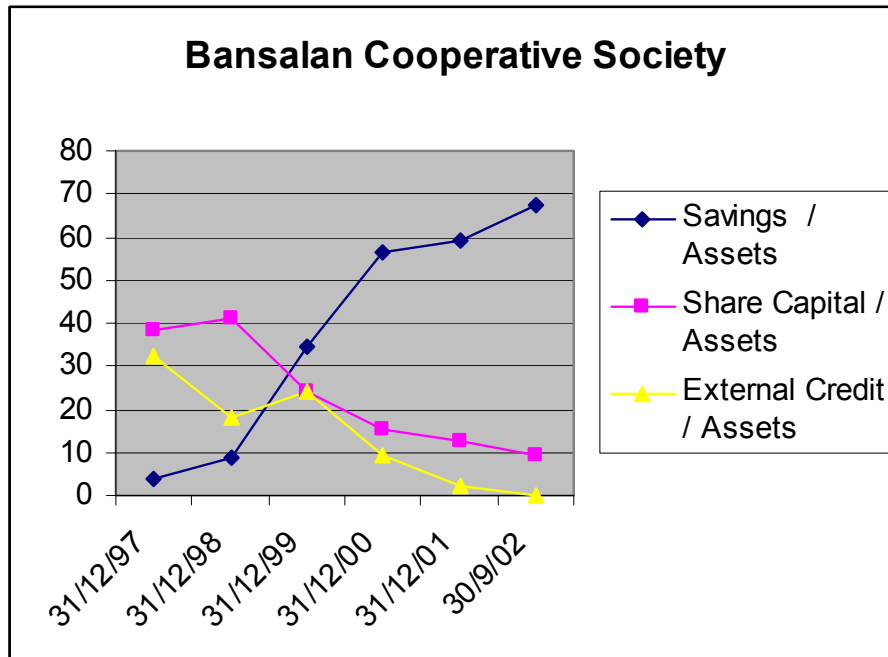
As previously described, the MCUB method seeks to turn loan-oriented, poorly managed credit unions into true financial intermediaries with balanced financial structures, liquid and protected savings, and clear growth and profitability.

The success of the CUES program is most clearly seen through a careful analysis of the financial data. The financial indicators show clearly that, as a result of the CUES program, participating credit unions are significantly more sustainable, profitable, and financially healthy than they were in 1997.

### A. Financial Structure

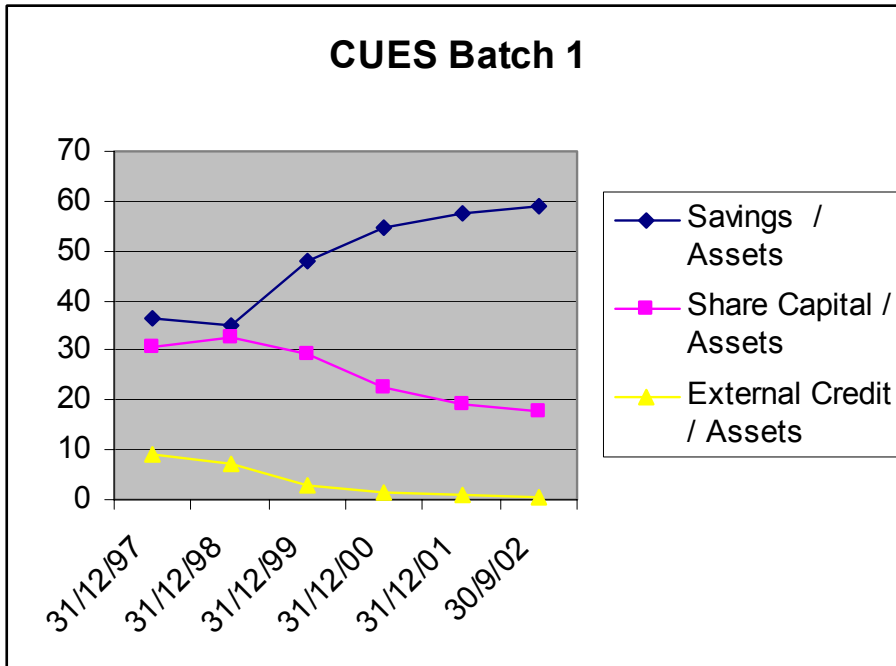
The MCUB method requires a fundamental change in the way a credit union is structured. Traditional credit unions are very loan oriented, and often give loans at subsidized rates to the detriment of savings or use external sources of funds which often cost more and are not reliably available.

Model credit unions move from reliance on non- withdrawable shares to withdrawable savings as a way to generate funds to increase their loan portfolio, reduce dependence on external sources of funds, and provide a valuable service to their members.



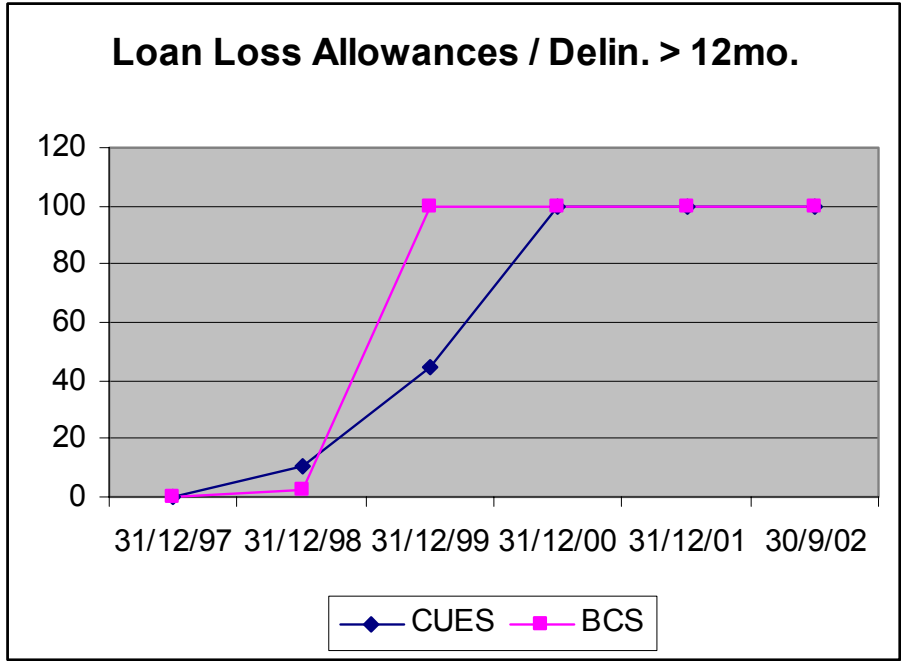
The transition of CUES credit unions is clear. As an example, Bansalan Cooperative Society (BCS) went from having savings over assets ratio of merely 4% in 1997 to 67% in September of 2002, while external credit dropped from 32% to only 0.25%.

This extreme evolution in asset structure is not unique to BCS. A similar trend is shown throughout the CUES program where savings as a percentage of assets has gone from 37% to 59% and external credit has dropped from 9% to 0.5%.

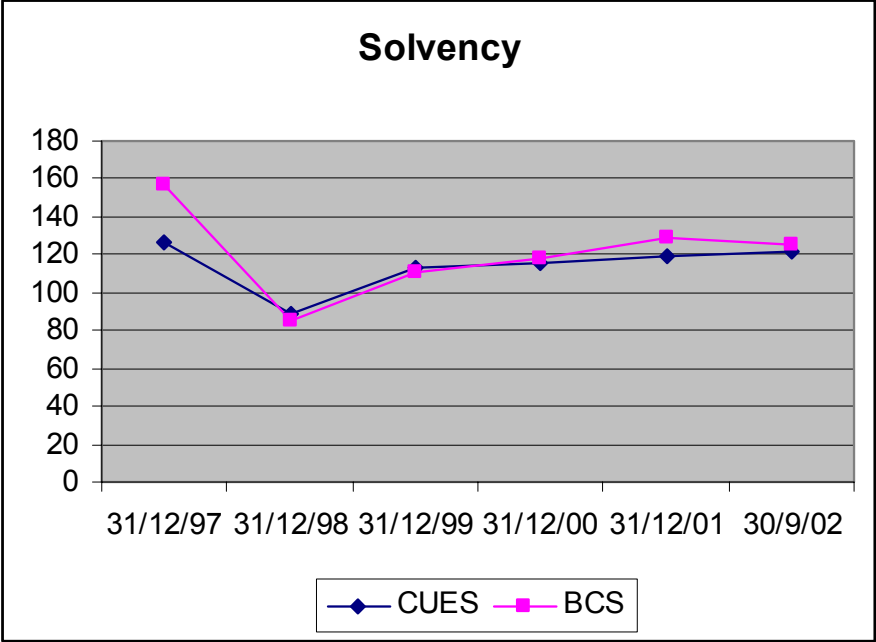


### B. Protection

The evolution of the financial structure of the CUES credit unions also places a greater responsibility on them to adequately protect the savings they have mobilized. CUES credit unions have made positive progress in protecting member savings.



In 1997, BCS, along with the rest of the CUES cooperatives, were not even recording delinquency, let alone providing prudent loan loss provisions. By December of 1999 BCS had 100% loan loss provisions for loans delinquent over 12 months and the CUES cooperatives as a whole had reached this same level a year later.

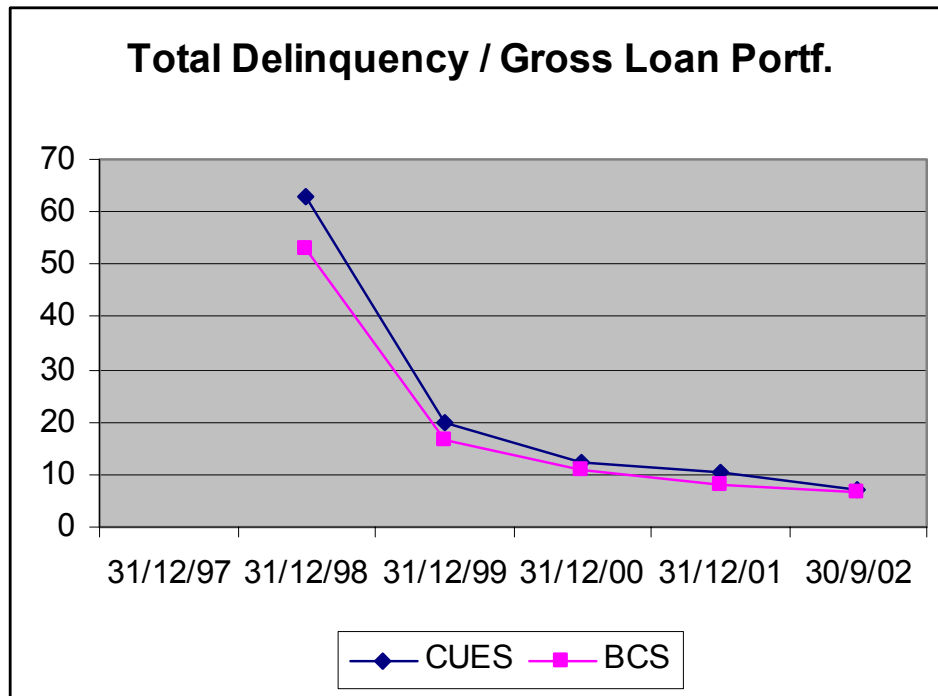


The importance of loan loss provisioning in understanding the true financial condition of an institution is also shown in the overstated solvency of CUES cooperatives. CUES cooperatives

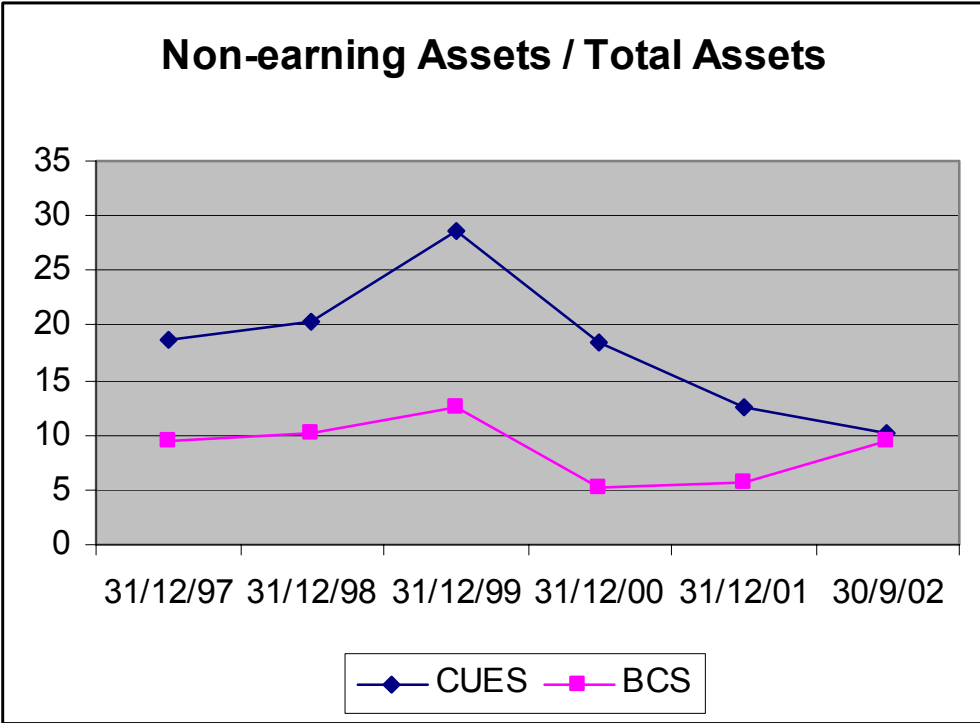
were shown to be a healthy 126% solvent in 1997, and BCS was at a robust 156%. However, as soon as loan loss provisions were taken into consideration, these numbers plummeted to 89% and 85% respectively, giving a much more realistic picture of institutional health. Solvency had again increased to 122% and 126% respectively by September 2002 – and because of correct provisioning these numbers do reflect the strong institutional health and protection provided to members.

**C. Asset Quality**

Very closely tied to protection is the issue of asset quality. Lending money carries inherent risk and the protection against that risk is achieved through loan loss provisioning and institutional capital. However, poor lending and poor collections will sink an institution.



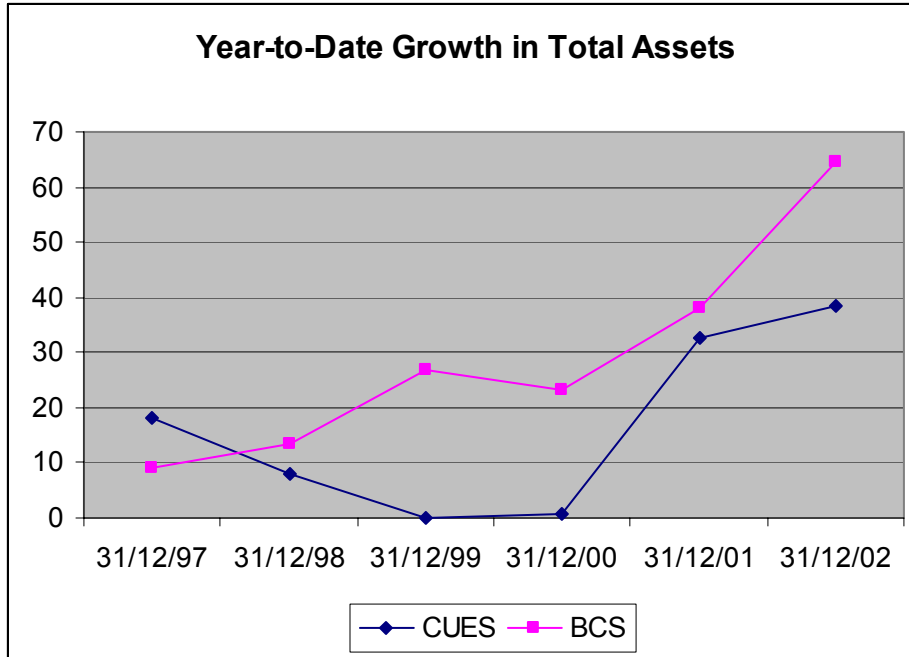
Delinquency is a clear indicator of both the portfolio quality and the ability of the institution to make good loan decisions in the first place. High delinquency is perhaps the clearest indicator of a dying credit union. The fact that BCS was not even measuring this vital statistic in 1997 shows the degree to which fundamental prudent accounting operations were needed. In December of 1998, BCS was measuring 53%, a figure which is over 10 times WOCCU’s recommended prudential standard. However, by late 2002, that figure had gone down to 6.7%. As a whole, CUES cooperatives went from 63% to 7% over the same period.



Credit unions are also more profitable if the majority of their assets are actually earning them money. Non-earning assets represent an opportunity cost that should be kept to a minimum. In this case BCS was not in terrible condition with 9% non-earning assets, but certainly not at an optimal level either. By Dec. 31 2001 that had been reduced to 5%. In December 2003 that rose again to 9%, but that was due to the construction of a branch office which was a well considered business decision and which should be offset by increased assets. Overall, CUES cooperatives were in very bad shape. Non-earning assets reached a peak of over 28% before getting under control at 10% in Sep. 2002.

**D. Growth**

Not only have CUES cooperatives been able to institute rigorous financial controls, but they've been able to do so while exhibiting robust growth. In December of 2002 the total assets of CUES cooperatives were growing at a pace of 38% per year. BCS was growing at 65% per year.



These numbers demonstrate that the MCUB approach, as applied in the Philippines, has not only provided increased levels of service to members through safer savings products, but done so while growing in self-sustainability and profitability.

It is also important to note that the MCUB approach has the same fundamental goal as the more “socially” oriented approaches of the past – the provision of quality financial services to the poor. What the MCUB approach acknowledges is that the best way to achieve socially responsible aims is to build organizations that are fiscally responsible and solid enough to provide sustainable services. The business orientation of the current approach is in direct response to past failures. The success in building sustainable institutions, as shown in the financial analysis provided above, coupled with the clear ability of these institutions to increase outreach (in both depth and absolute terms) clearly shows that the MCUB is superior in achieving social aims than ineffective and unsustainable “socially oriented” approaches of the past.

These combined indicators show clearly that, as a result of the CUES program, participating credit unions are significantly more sustainable, profitable, and financially healthy than they were in 1997.

More detailed financial performance data can be found in Appendix 1.

## **VI. Lessons Learned from Philippines late 90s vs late 1980s**

What has WOCCU learned from the last 10 years of work in the Philippines? The clearest way to answer this question is to focus on the differences between our original strategy and our current strategy and recognize the differences between the two to recognize strengths and weaknesses.

Savings and credit provide a dual benefit. First of all, they provide the necessary capital for investing in productive endeavors, improving existing productive capacity, providing capital for growth, and promoting both increased earnings and job creation. Secondly, savings and credit provide a buffer zone for poor families, allowing them to more easily cope with economic insecurity, crop cycles, and emergency consumption needs.

Historically microfinance organizations have been highly credit oriented and have not recognized the importance of savings. We have learned that if a credit union has the institutional capacity, there are many strategic advantages to mobilizing savings. First, properly implemented, savings mobilization contributes significantly to institutional self-sustainability. Savings can provide credit unions with a stable source of funds during periods of scarce external funds availability. Secondly, access to voluntary, withdrawable, and safe savings facilities has a stabilizing influence on poor households as compared to the stressful effects of debt. Household savings plays an array of roles from increasing personal wealth, to smoothing consumption, and investing in human capital; indeed, household savings continue to be the most frequent source of start-up capital for microenterprises or self-employment. Thirdly, greater scale and better quality outreach to the poor results from combined savings and credit services, rather than from credit alone. For every poor person looking for a loan, there are four to eight poor people looking for a safe and accessible place to save.

As cooperative institutions, credit unions provide these services without creating the dependency and lack of sustainability often associated with microfinance institutions who are almost entirely credit rather than credit-savings focused and whose loan portfolio is generally created through donations.

More information on savings mobilization can be found in Appendix 6, the Savings Technical Guide.

The Model Credit Union Building methodology was created in response to a lack of results from our traditional strategies. As noted in the introductory part of this case study, our methodology in the late 80s, which was overly based on attempts to prop up and improve national level organizations, was not successful in providing concrete results for members of Philippine credit unions.

The fundamental switch in our philosophy might be summed up by saying that we went from a top-down, system-level approach to an approach focused on individual credit union security and sustainability. The failure of the “old model” had less to do with a misunderstanding of the problems as overconfidence in the ability of national-level organizations to project skills and training down to their members and a focus on lending at the cost of savings. In the late 1990s WOCCU developed a new strategy that has been and continues to be the core of our development activities. This strategy is referred to as the Model Credit Union methodology because its focus is on largely bypassing traditional top-down national organizations and working directly with individual credit unions.

Our results in the Philippines provide a strong affirmation of the methodology which was first developed in Guatemala and then expanded to other Latin American countries (Ecuador, Bolivia, Nicaragua) before being tested in Asia. The Model Credit Union is a unique and now proven methodology that works with a defined number of credit unions in a country to establish minimum operating standards for others to follow. WOCCU's Model Credit Union development strategy focuses on:

- modernizing lending, collections, savings and internal control policies and practices
- mobilizing savings to assure a long-term, self-sustainable source of funds
- establishing financial disciplines to protect member savings
- improving the operational efficiency of credit unions
- building institutional capital to strengthen earnings, absorb losses and finance non-earning assets
- evaluating credit union performance using WOCCU's PEARLS system

### **Characteristics of a Model Credit Union**

A Model Credit Union is committed to self-sustainability. As such it assumes a business orientation in intermediating between members who want to save and those who want to borrow. It commits itself to the selection and development of quality leadership and employees.

A Model Credit Union relies on voluntary savings instead of non-withdrawable member shares and/or external capital to finance loans. Recognizing the fundamental role of mobilized member deposits, Model Credit Unions build three lines of defense to protect savings: 1) Loan loss provisions 2) Institutional capital 3) member shares (as only a last resort).

Model Credit Unions price savings and lending products to assure safety and operate efficiently, increase the variety of financial services offered, tighten up lending and collection practices, and adopt new policies to maintain soundness. In a relatively brief period, credit unions following the model typically experience unprecedented growth of loans, savings, capital and membership.

The methodology of Model Credit Unions employs six components: diagnostics, business plan, participation agreement, implementation, monitoring and evaluation, and the renewal, modification or completion of a program.

In the beginning of a project, World Council performs credit union diagnostics evaluating the financial condition, services, policies, loan portfolio and market potential. Once WOCCU decides to work with a credit union, the next step is developing a business plan. When the planning stage is complete, WOCCU generates a participation agreement with the credit union and sometimes the league. Program implementation includes technical assistance, on-site training, internships and sometimes financial assistance.

After implementation is under way, WOCCU staff monitors and evaluates the financial condition and growth of the credit union quarterly. Current ratios are compared with their business plan and the Model Credit Union standards.

WOCCU monitors a credit union's compliance with the Model Credit Union protocols annually.

This methodology helps develop safer and sounder financial intermediaries. Model Credit Unions in developing countries are just that models for other credit unions in the country to follow.

Key elements of a Model Credit Union Cooperative as they were implemented in the Philippines include:

**Ideology**

a business orientation to assure that social objectives are sustainable  
members come from diverse backgrounds  
member's reason for joining is to for safe and accessible savings as well as loans  
principal services to members include both savings and credit  
by-laws are updated to reflect current realities

**Financial Structure**

source of funds is withdrawable member savings/deposits  
minimal investment in non-earning assets

**Interest Rates**

loans made at rates which cover ALL costs plus a reasonable margin  
savings deposits are maintained at real rates of return which preserve real value  
shares (risk capital) is at least equal to inflation and more than savings

**Credit Administration**

loan analysis is based on repayment capacity  
loan size is determined by capital requirements, risk exposure, cash flow  
loan collateral is legally binding and convertible to cash

**Financial Disciplines**

delinquency is measured based on total outstanding loan balance/loan portfolio (accurate reporting)  
loan loss provision is based on 100% of all loans delinquent more than one year  
loan write-offs for all loans delinquent more than one year  
liquidity reserves are 10% to 25% of savings deposits  
risk management includes expanded coverage of all assets  
non-earning assets are less than or equal to 5% of total assets  
earnings retained to meet 10% or more net institutional capital reserves target  
accounting is balanced and timely  
planning and budgeting includes aggressive goal setting  
performance indicators are based on the PEARLS system

**Human Resources**

directors are business and service oriented attuned to savers as well as borrowers  
clear separation of board and management roles (Board focuses on setting policies and making Management accountable for implementation)  
employees are qualified professionals  
salaries are competitive with other local financial services providers

**Public Image**

the credit cooperative has accessible and appropriate business premises  
public areas of the cooperative are comfortable, well-lit and efficient  
quality security infrastructure and procedures  
employees wear appropriate attire on the job

## **VII: Unresolved issues in Credit Union Development**

Our early attempts to provide assistance to credit unions were well-intentioned but fundamentally flawed. We have shown in this case study how a revised methodology that builds on principles of self-sustainability strengthened the application of the cooperative model and provided concrete, positive impacts for our target populations.

Nonetheless, while the implementation of the Model Credit Union Building methodology has proven to be a very effective way of producing high-quality, sustainable credit cooperatives in areas where financial services have been unavailable or substandard, there are areas in which we feel there is a growing need to extend or improve our methodology.

While these “unresolved issues” are presented in the context of financial cooperatives we expect that many of these same issues will be similar in other types of cooperative organizations. It is important to note that we continue to believe, based on our results not only from the Philippines but from around the world, that the Model Credit Union Building methodology is highly effective. However, we now need to build upon that successful foundation and both extend that methodology and respond to challenges that are beyond the scope of the current methodology.

### **A. Legal and regulatory framework**

Credit cooperatives have a high level of responsibility to their members due to the fact that the institution mobilizes people’s savings and acts as an intermediary between borrowers and savers. If the credit union is inefficient or financially irresponsible, it puts the member’s savings at risk. These savings often represent a family’s life savings.

For this reason, it is very important that credit unions operate within a clear and effective legal and regulatory environment. Effective independent financial regulation, ideally on the part of existing banking regulator agencies, with the ability to impose sanctions within a clear legal framework provides the necessary level of control to reign in situations of financial mismanagement and fraud before such problems put member savings at risk.

In many parts of the world the existing legal and regulatory framework is substandard, and WOCCU considers this a key area that must be effectively addressed over the coming years.

The problem of legal frameworks is mostly a question of extending existing knowledge. WOCCU has developed a Model Law for Credit Unions as a guide to the creation and amendment of credit union law throughout the world. For more information on the Model Law for Credit Unions please see Appendix 5.

The regulatory aspect is more difficult. While a lack of credit union law is a major problem, we have found that poor regulation or non-enforceability render the best laws useless. These problems include a lack of willpower for regulatory enforcement, lack of resources, conflicts of interest, a lack of true power to impose sanctions, and a dearth of financial management capability on the part of the regulators necessary to both evaluate credit union management and to provide alternative management should problems be found.

The extension of credit union law, adapted to local conditions but generally based on the Model Credit Union Law, and the creation of effective regulatory systems are two key areas for continued development.

In the absence of effective or adequate government regulatory frameworks technical assistance providers such as WOCCU and donors such as USAID are challenged to fill the gap left by government agencies that lack will or capacity to monitor financial institutions.

### **B. New paradigms of credit union organization to provide increased competitiveness, economies of scale, and new services.**

Many existing structures for organizing cooperatives are political structures, rather than business/service driven networks. Often they are simply unable to respond to the growing needs and demands of their members for services such as shared branching, mutualization, and remittances.

This points to the need to foster financial networks that expand country-internal, cross-regional, and cross-national partnerships to include not just information exchange, but concrete business-driven services. In many regions this process has already begun but the creation of these partnerships will benefit from technical support in a range of issues from improved governance to the implementation of information technology solutions.

### **C. Governance**

One of the principle challenges which credit unions face in order to expand and become more significant actors in the financial marketplace is that of proper governance systems. It is important to analyze whether one of the very strengths of credit unions, member ownership and control, could at the same time be a source of some of the major problems in credit unions as well.

Two major problems in governance arise. One is the principal-agent problem; the elected directors and contracted managements' interest may diverge from the interest of the members. The resolution of these problems depend upon clear specification and enforcement of the institutional rules which define the roles and responsibilities of the actors involved in the governance of the credit union: decision making and decision monitoring. This is true of any financial institution. What is different about credit unions is that its owners are simultaneously its clients and that its clients are made up of two groups with different interests: net savers and net borrowers.

The second problem is the tendency of borrowers to dominate the Boards of Directors of credit unions. The resolution of this problem requires that balanced and updated services be provided which will tend to attract not only borrowers but savers to credit unions. This can also be controlled by restrictions upon loans to those who serve on boards. The presence of net savers on boards will lead to a more effective pressure upon credit union management and directors for the implementation of proper financial management and prudent governance that will protect the interests of savers and help ensure the long run sustainability of the credit union.

These measures may not be enough. Governance problems can still occur where structural rules are clearly specified and services are updated. External supervision serves as a final check to balance against governance problems. Supervision not only establishes the rules for behavior and responsibilities of actors but also monitors performance and enforces a prudential financial management framework which protects the members and their savings invested in the credit unions.

WOCCU has worked extensively with project credit unions to find concrete solutions to governance issues. It is important to continue to extend the knowledge gained in this process, as good corporate governance continues to be a principal challenge to credit unions and other microfinance institutions alike.

#### **D. Tools development**

While the Model Credit Union Building methodology has proven to be highly effective, continued tools development is critical. Complacency is the death knell of effective development tools. The best tools are those that are improved and evolve to meet changing, dynamic situations and needs.

WOCCU has created high quality credit union development and management tools. These include the PEARLS monitoring system, a business planning module, model laws, and policies and procedures for savings mobilization, credit analysis, credit administration, and internal controls. These tools must be continually improved and updated and new tools must be developed, including new tools for financial diagnostics and institutional assessment.

The creation of new tools and the promulgation of models that will support improved governance and supervision is another key need. This would include both the creation of new tools based on best practices (and lessons learned from worst practices) from around the world as well as the diffusion of existing tools and models.

Finally, to be competitive cooperatives may benefit from linkages between each other that provide the means to providing new competitive services to their members that respond to their real needs. Many existing structures for organizing cooperatives are political structures, rather than business/service driven networks. The increasing need and demand for services such as shared branching, mutualization, and remittances point to a need to foster financial networks that expand country-internal, cross-regional, and cross-national partnerships to include not just information exchange, but concrete business-driven services.

## **Appendix 1: Financial Reports for Bansalan Cooperative Society**

## **Appendix 2: Financial Reports for “Batch 1” CUES Credit Unions**

Full PEARLS reports, balance sheets, and income statements for the Bansalan Cooperative Society and for Batch 1 CUES credit unions will be included in the hard copy of this case study.

For electronic copies, please contact Andrew Turner, [aturner@woccu.org](mailto:aturner@woccu.org).

## **Appendix 3: CUES Implementation Strategy**

In the Philippines WOCCU has taken an integrated approach to the roll out of the Model Credit Cooperative Building and Savings and Credit with Education product. The following describes the how the implementation was conceptualized in the first year of start-up in 1997:

### **Project Component 1: Model Credit Union Building**

#### **a. Credit Cooperative Assessments**

CUES-Philippines staff will begin conducting institutional assessments in the first quarter of the program and will continue until all Credit Cooperatives who have expressed interest in participating have been evaluated. There are 60 credit cooperatives located in the Davao del Norte province. It is expected that all of the assessments will be completed within the first 18 to 24 months of the program. Local federations may be involved in the assessment process.

#### **b. Model Candidate Selection**

The specific criteria for candidate selection will be developed in the very early stages of the program. Credit cooperatives that demonstrate the following attributes will be given preference in the selection process:

- a. There exists a clear willingness to participate and make reforms on the part of the board of directors and management;
- b. The credit cooperative has demonstrated financial responsibility in the past;
- c. There is some degree of liquidity and low external loan dependency;
- d. The credit cooperative has been profitable the last three years and has audited financial statements;
- e. There is strong probability of accelerated growth;
- f. The credit cooperative possesses a marketing focus;
- g. The capital ratio is at an acceptable level and is growing;
- h. Large credit cooperatives with the capacity to manage the *Savings and Credit with Education program*.

#### **c. Contractual Arrangements**

Once a credit cooperative has been selected to participate, a contract will be

signed with the CUES-Philippines Program Office. The agreement will spell out specific responsibilities of each party and contain termination provisions. Agreements used by the CUES-Philippines Program are renewable on an annual basis, subject to satisfactory performance based on agreed workplans.

#### **d. Business/Marketing Plans**

Business and marketing plans will be developed immediately after the candidate has signed an agreement. Specific benchmarks will be established, a reporting schedule will be set up, and monitoring systems will be put in place at the CUES-Philippines Program Office level.

#### **e. Member Surveys**

CUES-Philippines program office will provide technical assistance to the credit cooperative partners on member survey design, distribution, compilation & analysis. The purpose of the surveys is to help determine members' service needs and to design appropriate products directed at micro-entrepreneurship.

#### **f. Balance Sheet Clean-Up and Credit Administration**

This fundamental step is the heart of Model Credit Union Building. Accounting and financial reports are standardized. Bylaws and policies are revised and approved. Partner credit unions are trained on the model credit union concept and in the use of tools including the PEARLS monitoring system. Credit unions are trained on delinquency control, credit administration, and asset quality. Only those credit unions that demonstrate significant progress here are allowed to move to the next step.

#### **g. Development Grants/Savings Mobilization**

Credit Cooperative facilities upgrading and marketing activities will be supported through development grants controlled by the CUES-Philippines Program. The allocation of the expenditure between physical upgrading and marketing will be made by the CUES-Philippines Program and the credit cooperative. The grants will be disbursed over time rather than on a lump-sum basis. Only credit cooperative expenditures authorized by the CUES-Philippines Program will be paid. This step is seen as crucial in savings mobilization. In order to raise the funds necessary for micro-lending, a portion of the *Savings and Credit with Education* loan program will be delayed to allow for liquidity to flow into the credit cooperative.

Development grants are provided for facilities upgrading and marketing activities as directed by the program director. The allocation of these expenditures relates to the business and marketing plans and is allowed as specific targets are reached.

#### **h. Savings and Credit with Education Early Formation**

In this step, field agents are hired and trained, credit cooperative personnel are

trained, and women's groups are beginning to be formed. Marketing of the Savings and Credit with Education program occurs during this phase.

#### **i. Micro-lending to Cooperative Members**

Association begin allying for productive credit. The time span between the savings mobilization effort of the credit cooperative and the SCAs requesting credit is a minimum of 9 months and maximum of 14 months.

### **Project Component 2: Savings and Credit with Education**

The following activities generally follow a sequence however, some activities are performed simultaneously or interchangeably depending on the need and situation presented:

#### **a. Selection of Partner Cooperatives**

Cooperatives interested in participating with the CUES Program and able to satisfy eligibility criteria for a financially and managerially capable cooperative are identified. This involves the following activities:

***Orientation*** - Orientation of the board and management on the Program components, its relevance and possible impact to the cooperative and its members are conducted through conferences, meetings and actual visitation.

***Diagnostics Survey*** - A complete institutional diagnostics is performed on potential partners to have a clear view of their vision, mission and goals and to better understand its operational policies, systems and procedures. This also include gathering of some socio-economic data to test suitability and viability of the Program design and services.

***Contractual Arrangements*** - Based on the data gathered, potential partners are selected and a contract is drawn on a per cooperative basis.

#### **b. Demographic, Health, and Nutritional Assessment**

***Regional Level*** - Demographic and health assessment is performed on the regional level to determine the potential of an area, the general level of understanding on health and nutrition, and the availability of facilities and education materials for the community. It is also a way to determine how the services, if there are any, are being provided and if training or collaboration is possible.

***Local Level*** - Demographic and health assessment on a local level is also performed and used as basis in designing strategic plans for the cooperative concerned. The coverage of the assessment varies depending on the scope of operation (whether regional, provincial or municipal) of the cooperative.

#### **c. Strategic Planning for SCWE**

The following activities are done together with the cooperative board and management to obtain maximum output and these are used as addendums to the contracts signed with the cooperatives.

***Knowledge, Attitude and Practices / Credit Assessment*** - This is a survey conducted to a potential community for the SCWE activities using women who are not members of the cooperative as respondents. This survey measures the local knowledge and practices on health and nutrition as compared to the ideal behaviors the SCWE program promotes, and the general attitude towards credit as input in the planning and implementation of the education, savings mobilization, credit delivery and marketing activities.

***Business Planning Session*** - This intensive planning session is conducted to define the cooperative goals, benchmarks and time line for program activities. The business and marketing plans are developed at the conclusion of the planning sessions and these serve as bible of the cooperative in the conduct of its operation.

#### **d. Staffing and Training**

***Staffing*** - A supervisor is selected to oversee the implementation of the SCWE activities and handling of program reports and communications at the cooperative level, frequency of which is determined on a per need basis. Field agents are hired based on the qualification criteria and are deployed in the selected communities for SCWE. Preferably, these field agents are chosen from the enumerators hired in the conduct of KAP and Credit Assessment.

***Training*** - The field agents and their supervisors are trained to promote, organize, train and manage the Savings and Credit Associations (SCAs). The training includes credit and savings service delivery and education content and delivery techniques. Field agents, supervisors and appropriate cooperative staff are trained in program monitoring, reporting and analysis. Selected cooperative staff will receive an orientation on the SCWE methodology and training on program planning, preparation of financial projections and financial reporting which includes bookkeeping, accounting, budget and expense preparation and analysis. Further, they are trained on how to interpret program reports and assess program progress.

#### **e. Setting Up Management Information Systems**

The following activities are integrated with the current system of the cooperative to avoid overlapping/conflicting functions and achieve maximum efficiency in its operation:

***Management Information Systems*** - SCWE management information systems are established at the level of the SCA members, SCA, Field Agent, Supervisor and the Cooperative. Model forms and instructions for information collection exist and are adapted to fit with the cooperatives' existing procedures and information needs. An annual program assessment is conducted to determine outreach, efficiency, and progress toward full cost recovery as well as results of

education learning sessions.

**Documentation** - Local experiences relative to the implementation of the SCWE are documented to form part of the adaptations to the monitoring and reporting systems, training manuals (for the SCAs, Field Agents and Coordinator) and lesson plan series. The annual program assessment is also documented and used as reference in future planning sessions.

#### **f. Group Formation, Education, and Lending Activities**

**Site and Communities Selection** - This is performed to help the cooperative determine where to initiate the SCWE activities. The site and communities should indicate potential for establishment and growth of the SCAs.

**Orientation** - An orientation is conducted to target community to disseminate information regarding the cooperative and the SCWE services and benefits. It also used to assess the level of interest of a certain community and the feasibility of implementing the program.

**Group Formation** - In an identified group where level of interest is high, group formation activities are started by identifying solidarity groups and forming SCAs.

**Savings and Credit Association Training** - SCA training is conducted for four half-day training sessions over a four week period. On the fifth week, after successful completion of the training, the SCAs are officially inaugurated and provided with the first loan.

**Non-formal Education** - The SCAs are trained on high impact topics (i.e. savings mobilization, proper management of SCAs and micro-enterprise and ideal behaviors or practices in health/nutrition based on the results of KAP survey) using non-formal education techniques during weekly meetings.

**Micro-lending** - The SCAs are provided with small loans to finance their income generating activities. This loan is secured by the group, is payable weekly for 16 weeks and maybe charged with interest rate higher than the regular programs of the cooperative.

For facilitation purposes, the operating costs of the implementation of the SCWE program not covered through interest earnings on the SCWE loans are subsidized by the Program until break-even, according to the projections in the business plans. These costs include motorcycles (for the field agents), personnel compensation and allowances, transportation, travel, training and other direct costs.

#### **Appendix 4: PEARLS Technical Guide**

For electronic copy of the Pearls Technical Guide, please contact Andrew Turner, [aturner@woccu.org](mailto:aturner@woccu.org).

## **Appendix 5: Overview of WOCCU's Model Law for Credit Unions**

### **INTRODUCTION**

Credit unions have been important contributors to economic and social development for over 150 years in all regions of the world. Credit unions are now significant participants in the national financial markets of many industrialized, developing and transitional economies. In many jurisdictions, however, legislation has not kept pace with the development of credit unions. Legislative and regulatory deficiencies imperil the safety and soundness of credit unions and restrict their ability to meet their members' financial service needs. Credit unions lacking adequate legislation often find themselves limited in mobilizing savings and making loans to the lower- and middle-income groups they generally serve. Also, they are unable to participate fully in national financial markets, where their services could contribute to greater economic efficiency and expanded development opportunities for current and potential members.

### **PURPOSE OF THE MODEL LAW**

The purpose of this *Model Law for Credit Unions* is to aid movement leaders, legislators, regulators and others in preparing and seeking approval of laws which will strengthen the safety and soundness of credit unions while taking into account their uniqueness as cooperative financial institutions.

Credit unions in most developing countries are not registered or regulated under specific credit union legislation. Rather, they are subject to the same general cooperative societies acts that regulate the business operations of nonfinancial cooperatives and, in a few countries, some sections of financial institution or banking acts. As a result, many credit unions are engaged in a variety of non-financial business activities; they are not subject to prudential standards generally applicable to other financial institutions, and they are denied direct access to financial sector services such as central bank borrowing and clearing of payments. Helping credit union movements to address these deficiencies is the goal of the publication.

### **Model Law Table of Contents**

#### **PREFACE TO THE MODEL LAW FOR CREDIT UNIONS**

#### **A USERS GUIDE**

#### **ACKNOWLEDGMENTS**

#### **PART I PRELIMINARY**

1.10 Title of Act

1.15 Effective Date

1.20 Repealer or Transitional Provisions

1.25 Application to Other Acts

1.30 "Credit Union" Defined

1.35 Interpretations and Definitions

#### **PART II ORGANIZING A CREDIT UNION**

2.10 Organizational Procedure

2.15 Criteria for Registration

2.20 Organization Application and Bylaws

2.25 Use of Name "Credit Union"

2.30 Fiscal Year

2.35 Prudential Standards

2.40 Other Credit Unions

**PART III POWERS OF A CREDIT UNION**

3.10 General Powers

3.15 Other Powers

**PART IV MEMBERSHIP OF A CREDIT UNION**

4.10 Field of Membership

4.15 Others Eligible for Membership

4.20 Admission to Membership

4.25 Termination of Membership

4.30 Liability of Members

4.35 General Meetings of Members

4.40 Regional Meetings of Members

**PART V MANAGEMENT AND ADMINISTRATION**

5.10 Authority of Board of Directors

5.15 Executive Officers

5.20 Credit Committee

5.25 Supervisory Committee

5.30 External Audit

5.35 Vacancies in Offices

5.40 Chief Operating Officer & Employees

5.45 Conflicts of Interest

5.50 Compensation

5.55 Insurance on Officials

**PART VI SHARES AND DEPOSITS**

6.10 Ownership Shares

6.15 Dividends

6.20 Deposits

6.25 Interest on Deposits

6.40 Trust Accounts

6.45 Charge against Shares and Deposits

6.50 Dormant Accounts

**PART VII LOANS**

7.10 Purpose and Conditions

7.15 Loan Limits and Security

7.20 Interest and Other Charges

7.25 Loan Application Procedure

7.30 Other Loan Programs

7.35 Loans to Credit Union Officials

**PART VIII INVESTMENT OF FUNDS**

8.10 Board Responsibility

8.15 Authorized Investments

8.20 Liquid Funds

**PART IX RESERVES AND ALLOWANCES**

9.10 General Reserve

9.15 Use of General Reserve

9.20 Allowance for Loan Losses

9.25 Loan Write-Offs

**PART X CREDIT UNION ASSOCIATIONS**

10.10 Association of Credit Unions

10.15 Services of a Second-Tier Organization

10.20 Central Finance Facility

10.25 Powers of Central Finance Facility

**PART XI REGULATION AND SUPERVISION**

11.10 Government Supervision

11.15 Officers and Employees

11.20 General Powers of the Superintendent

11.25 Enforcement Powers of the Superintendent

11.30 Administration

11.35 Merger by the Superintendent

11.40 Involuntary Liquidation of a Credit Union

11.45 Establishment of a Stabilization Fund

11.50 Powers of the Stabilization Fund

11.55 Financing the Stabilization Fund

11.60 Governance of the Stabilization Fund

**PART XII VOLUNTARY CHANGES IN ORGANIZATION 47**

12.10 Merger and Consolidation

12.15 Voluntary Liquidation

12.20 Conversion

**PART XIII GENERAL PROVISIONS**

13.10 Documents and Records

13.15 False Reports

13.20 Criminal Offenses

13.25 Exemptions

**APPENDIX**

Statement of Credit Union Operating Principles

WOCCU's International Credit Union

Prudential Standards

Glossary

Subject Index

## **Appendix 6: Savings Technical Guide**

For electronic copy of the Savings Technical Guide, please contact Andrew Turner, [aturner@woccu.org](mailto:aturner@woccu.org).