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# AGRICULTURAL FINANCING:

## A Case Study of the Land Bank of the Philippines

## Fair Finance Asia Briefing Papers

Fair Finance Asia Briefing Papers are written to generate data-driven evidence, contribute to public debate, and to invite feedback on sustainable finance policy issues.

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Fair Finance Asia- Philippines is a member of Fair Finance Asia, a regional network of Asian civil society organizations committed to ensuring responsible banking and sustainable finance across Asia. The coalition is formed by five Philippines-based organizations that advocate for the effective adoption of environmental, social, and governance (ESG) criteria in banking to mitigate the negative effects of irresponsible investments. We work with civil society, regulators, and financial institutions to build the capacity of banks to implement ESG policies, enable CSOs to effectively advocate for sustainable finance, and develop impactful, evidence-based research and case studies for awareness-raising on sustainable finance among consumers.

## Disclaimer



A draft of this study was sent to the Landbank of the Philippines for comments, but as of May 2022, they have yet to give their feedback, if any.

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# LIST OF ACRONYMS

| | |
|---|---|
| APCP | Agrarian Production Credit Program |
| AFF | Agriculture, Fisheries and Forestry |
| AFFP | Agriculture, Fisheries and Financing Program |
| AFMA | Agriculture and Fisheries Modernization Act |
| AMCFP | Agro-Industry Modernization Credit and Financing Program |
| AVA | Agribusiness Venture Arrangement |
| AGFP | Agriculture Guarantee Fund Pool |
| AIS | Agricultural Indicators System |
| ANGOC | Asian NGO Coalition for Agrarian Reform and Rural Development |
| ARBs | Agrarian Reform Beneficiaries |
| ARCs | Agrarian Reform Communities |
| BPI | Bank of the Philippine Islands |
| BSP | Bangko Sentral ng Pilipinas |
| CARP | Comprehensive Agrarian Reform Program |
| CEO | Chief Executive Officer |
| CFI | Corporate Finance Institute |
| COA | Commission on Audit |
| DA | Department of Agriculture |
| DAR | Department of Agrarian Reform |
| DBP | Development Bank of the Philippines |
| ESG | Environmental, Social, and Governance |
| FA | Farmers' Associations |
| FAO | Food and Agriculture Organization |
| FDC | Freedom from Debt Coalition |

| | |
|---|---|
| FFA | Fair Finance Asia |
| FFGI | Fair Finance Guide International |
| GDP | Gross Domestic Product |
| GOCC | Government-Owned Controlled Corporations |
| IDEALS | Initiatives for Dialogue and Empowerment Through Alternative Legal Services |
| IFC | International Finance Corporation |
| IRR | Implementing Rules and Regulations |
| ISDA | Integrated Support for the Development of Aquaculture Program |
| LBP | Land Bank of the Philippines |
| MSME | Micro, Small and Medium Enterprises |
| PCIC | Philippine Crop Insurance Corporation |
| PKBs | Private Commercial Banks |
| PSA | Philippine Statistics Authority |
| RA | Republic Act |
| RBs | Rural banks |
| SEC | Securities and Exchange Commission |
| TBs | Thrift banks |
| U/KBs | Universal and Commercial Banks |
| WWF-Ph | World Wide Fund for Nature Philippines |

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# INTRODUCTION

The Philippines is committed to achieving the 17 Sustainable Development Goals (SDGs) and their 169 targets by 2030. Among the 17 global goals is SDG 2, a global goal **"to end hunger, achieve food security and improve nutrition and promote sustainable agriculture."** This entails improving the productivity and incomes of small-scale farmers by promoting equal access to credit, land, technology, and market (United Nations, 2019). This goal can be achieved through agricultural financing, which is crucial in order for farmers to support their farm productivity and income.

In line with the Philippines' commitment in improving the agricultural financing in the country, it is important to examine the Land Bank of the Philippines' (LBP) lending performance in the agriculture sector. Through the Republic Act (RA) 3844 or the Agricultural Land Reform Code, the LBP was created to finance the acquisition and distribution of agricultural estates for division and resale to small landholders and the purchase of landholdings by agricultural land tenants. In short, LBP's social mandate is to provide financial inclusion programs for farmers and fisherfolk.

The caveat here, however, is that the agriculture sector's gross domestic product (GDP) growth has been alarmingly slow during the period of 2015 to 2019 compared to the GDP growth of services and industry as seen in Figure 1.

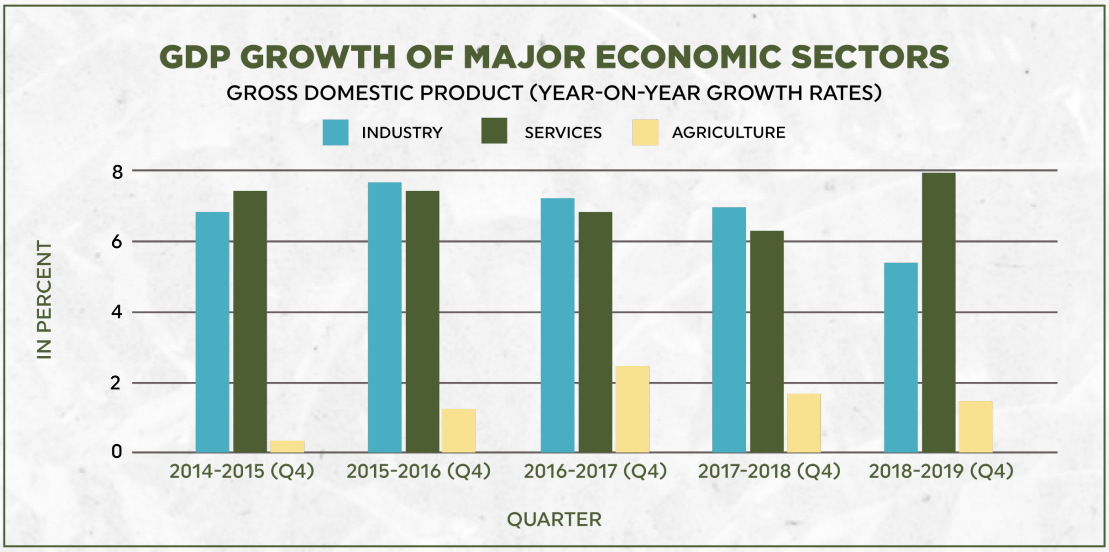


*Figure1. GDP annual growth rates by sector, Philippines (2014-2019)*
*(Source: Philippine Statistics Authority, 2020a)*

The sector's stagnant performance is a result of several factors that come into play. A factor to consider is agriculture's susceptibility to extreme weather phenomena such as droughts and typhoons. In November 2013, Typhoon Yolanda damaged crops, property, and infrastructure worth PHP 361 billion or USD 7.5 billion (International Finance Corporation, 2018). More so, devastation from Typhoon Urduja in December 2017 reached an estimated PHP 1 billion, damaging 23,829 metric tons of farm output, and affecting the livelihood of 38,466 farmers (World Bank, 2018).

Another contributing factor is the agriculture sector's composition of individuals who belong to sectors posting the highest poverty incidence rates. Farmers exhibited the highest poverty incidence rates among the basic sectors, with 41% in 2015 and 32% in 2018 as a consequence of low rural incomes that are below the official poverty threshold (Philippine Statistics Authority, 2020a). Because of these low rural incomes (whether as farmers or farm workers), people working in agriculture are more exposed to various risks such as climate change, extreme weather events, pests, and disease; lack of access to productive resources such as land and capital; and are more vulnerable to hunger (Focus on the Global South-Philippines, 2014). Hence, as farmers experience these, it can directly affect agricultural productivity, well-being, and incomes.

Given the risks associated with farmers, banks are unwilling to extend loans to them (Llanto, 2005; Geron, Llanto & Badiola, 2016). One major barrier to smallholder finance is the lack of traditional collateral such as real estate mortgages. This concern is brought by the passage of the Comprehensive Agrarian Reform Program (CARP), established in 1988 through RA 6657 and later expanded in 2009 through RA 9700. Llanto (2005) purported that the prohibition on mortgaging CARP lands has weakened its value as collateral from the perspective of banks. This is because CARP-distributed lands cannot be transferred (through sale, lease, or other means) until it is fully paid and the title is fully vested in the agrarian reform beneficiaries (ARBs).

Therefore, it is important to examine the role of LBP as a government financial institution, which has a social mandate to provide credit services to the agriculture and fisheries sector especially to small farmers and fisherfolk (Land Bank of the Philippines, 2018a; Section 14, RA 8435). LBP's lending performance in the agriculture sector is an important factor to improve farmers' income and productivity. Without agricultural financing, poor farmers would not be able to increase their farm production and income.

## STATEMENT OF THE PROBLEM

The Fair Finance Asia Philippines[1] assessed the bank policies of five major banks-including LBP- in the country using the Fair Finance Guide International (FFGI) methodology.[2] To determine each bank's rating, FFGI considered both the content and scope of policies related to each theme. This was derived from annual reports, sustainability reports, banking policies and other information publicly disclosed by the banks. The highest score for each theme is 10 and 1 being the lowest. Based on the findings of the 2019 FFA policy assessment, LBP scored low in the following themes of the methodology: **climate change, corruption, human rights, labor rights, nature, tax, arms, transparency, gender, consumer protection and financial inclusion**[3]. LBP only scored 2 out of 10 in climate policies, despite the Philippines being one of the most climate-vulnerable countries in the world. Table 1 shows LBP's scores for each theme.

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[1] The Fair Finance Asia- Philippines is a member of Fair Finance Asia, a regional network of Asian civil society organizations committed to ensuring responsible banking and sustainable finance across Asia. The coalition is formed by five Philippines-based organizations that advocate for the effective adoption of environmental, social, and governance (ESG) criteria in banking to mitigate the negative effects of irresponsible investments. These organizations are the Initiatives for Dialogue and Empowerment through Alternative Legal Services (IDEALS), Asian NGO Coalition for Agrarian Reform and Rural Development (ANGOC), NGO Forum on ADB (the Forum), Freedom from Debt Coalition (FDC) and the World Wide Fund for Nature Philippines (WWF-Ph), specifically its sustainable finance team.

[2] The Fair Finance Guide International Methodology intends to assess and rank financial institutions' finance and investment policies regarding their principles on sustainable development and corporate social responsibility. The methodology is developed by Profundo together with the civil society organizations collaborating in Fair Finance Guide International—an international civil society network initiated by Oxfam in 2009. Fair Finance Asia is part of this network together with Fair Finance Guides in Europe and Brazil.

[3] The FFGI has three major themes. These are 1) cross cutting themes, 2) sector themes and operational themes. The cross-cutting themes include animal welfare, climate change, corruption, gender equality, health, human rights, labor rights, nature and tax. The sector themes include arms, financial sector, fisheries, food, forestry, housing and real estate, manufacturing industry, mining, oil and gas and power generation. The operational themes include consumer protection, financial inclusion, remuneration and transparency and accountability. The FFA-Philippines only chose climate change, corruption, human rights, labor rights, nature, tax, arms, transparency, gender, consumer protection and financial inclusion because these are relevant themes and issues prevailing in the country in the present period.

| FFI Methodology Result: Land Bank of the Philippines | |
|---|---|
| Climate Change | 0.2 |
| Corruption | 4.2 |
| Human Rights | 1.5 |
| Labor Rights | 0 |
| Nature | 0.3 |
| Tax | 1.8 |
| Gender Equality | 0 |
| *SECTOR THEMES* | |
| Arms | 0 |
| *OPERATIONAL THEMES* | |
| Consumer Protection | 2.6 |
| Financial Inclusion | 5.8 |
| Transparency and Accountability | 2.1 |
| TOTAL | 1.7 |

*Table 1. FFGI Methodology Result: Land Bank of the Philippines*
*(Author's illustration based on the FFA-Philippines' 2019 bank policy assessment)*

Aside from climate change, financial inclusion is another major reason in explaining the stagnant performance of the agriculture sector. One manifestation of this is the fact that accessing rural finance is still problematic in the country. Many farmers have little or no access to credit at all, which is crucial in order to boost farm productivity and income (Food and Agriculture Organization, 2016; Brown, Decena and Ebora, 2018). Given this, it is interesting to examine the role of LBP in providing financial services for the small farmers and fisherfolk. As such, the study aims to answer the following research questions:

1. **What is the current status of agricultural financing in the Philippines?**
2. **What is the current LBP's lending performance in the agriculture sector?**
3. **How do ARBs view LBP's lending performance in the agriculture sector?**

# METHODOLOGY

## RESEARCH DESIGN

The study is **qualitative,** examining the overall lending performance of LBP to the agriculture sector. The **first part of the study covers the current status of agricultural financing in the Philippines at the macro level.** This was done by analyzing the existing literature on access to credit in the rural areas. Other than this, the study interviewed the Bangko Sentral ng Pilipinas (BSP) as the primary regulator of banks on the revised implementing rules and regulations (IRR) of Agri-Agra Law, and how it can improve bank lending for agricultural projects and borrowers. It is important to note that the researcher wanted to interview BSP about LBP's lending performance in the agriculture sector. However, BSP explained that Section 27 of RA 7653 or The New Central Bank Act prohibits BSP personnel from releasing bank-specific information, such as information on the operations of LBP, to the public. Thus, the focus of the interview was the implementation of Agri-Agra Law and the BSP's policy direction on sustainable finance.

The **second part of the study examined the current LBP's lending performance in the agriculture sector.** It employed a case study design which pertains to "an empirical inquiry that investigates a contemporary phenomenon in depth and within its real-life context, especially when the boundaries between phenomenon and context are not clearly evident" (Yin, 2009: 4 as cited in Willis, 2014). The design in this particular study focused on the "intensive case study of a single unit" (Gerring, 2004: 342 as cited in Willis, 2014). In this case, the study used publicly available documents including the LBP website, news articles and its 2020 annual report. Other public documents used were 2021 BSP documents related to financial institutions and 2019 COA annual report on GOCC. Also, the study interviewed LBP via written correspondence. The interview questions were emailed to LBP on October 8, 2021 and it returned the questions with answers on November 10, 2021.

Most importantly, the study surveyed 23 ARBs in Davao De Oro to get their views and perspectives regarding the role of LBP in providing access to credit in the agriculture sector. The caveat here, however, is that the researcher was not able to conduct another survey in other areas aside from Davao given COVID-19 pandemic travel restrictions. Nevertheless, the results of the survey in Davao were triangulated with official documents, newspaper clippings, government press releases online and previous studies in constructing a narrative to answer the research questions and come up with recommendations.

# CURRENT STATUS OF AGRICULTURAL FINANCING IN THE PHILIPPINES

Agricultural financing plays an important role in empowering farmers. **Access to credit allows these farmers to purchase inputs to make farming more productive and profitable.** However, the lack of access to credit is still a major concern for farmers in the Philippines given the inherent risks in the agriculture sector (FAO, 2016; Brown, et.al. 2018).

This section is divided into three parts. The first part looks into the loans given in the agriculture and fisheries sector. Specifically, it intends to examine the rate of Agriculture, Fisheries and Forestry (AFF) loans. The second part discusses the issues and challenges being encountered in the implementation of Agri-Agra Law. The last part examines the approved amendments to the implementing rules and regulations (IRR) of the Agri-Agra Law in February 2021.

1. **The Agriculture, Fisheries and Forestry (AFF) loans in the Philippines**
2. **The Agriculture, Fisheries and Forestry (AFF) loans in the Philippines**
3. **Approved Amendments to the Implementing Rules and Regulations (IRR) of the Agri-Agra Law in February 2021.**

## The Agriculture, Fisheries and Forestry (AFF) loans in the Philippines

In the Philippines, the 2020 Agricultural Indicators System (AIS) report from the PSA found that the rate of AFF loans have been fluctuating since 2015. In 2019, AFF loans were valued at PHP 741,787 million; PHP 414,985 million of which were dedicated to agricultural production as seen in Table 2. The share of agricultural production loans to AFF peaked from 2016-2017, and continued to decline in the following years.

| YEAR | AGRICULTURAL PRODUCTION LOANS | | AGRICULTURE, FISHERIES AND FORESTRY LOANS | |
|---|---|---|---|---|
| | AMOUNT (IN MISSION PHP) | GROWTH RATE (%) | AMOUNT (IN MILLION PHP) | GROWTH RATE (%) |
| 2015 | 378,035 | 40% | 507,566 | 36% |
| 2016 | 322,179 | -15% | 351,881 | -31% |
| 2017 | 453,649 | 41% | 485,400 | 38% |
| 2018 | 378,830 | -17% | 694,238 | 43% |
| 2019 | 414,985 | 10% | 741,787 | 7% |

*Table 2. Amount and Share of Agricultural Production Loans in Agriculture, Fisheries and Forestry Loans, Philippines 2015-2019*

*P – Preliminary. Amounts were estimated due to non-availability of actual data.*

*(Source: PSA, 2020a, p.11)*

The majority of the total loans were provided by private financial institutions, as shown in Table 3. Private banks—consisting of Private Commercial Banks (PKBs), Thrift Banks (TBs) and Rural Banks (RBs)—contributed at least 79% to AFF loans in 2019.The amount of privately granted loans experienced a sharp decline in 2018 but recovered by 8% in 2019 (PSA, 2020a). On the other hand, government banks such as the Development Bank of the Philippines (DBP) and LBP have only contributed approximately 12% until 2017; their contribution grew by 64% in the following year. Despite the change in percentage distribution, both private and government banks increased their volume of loans in 2019 (PSA, 2020a). Private banks, in general, are able to contribute more because there are more private institutions compared to government-owned ones. A total of 524 banks supervised by the BSP were recorded in 2021. The classification of these banks are as follows: 46 universal and commercial banks, 48 TBs, 430 RBs (Bangko Sentral ng Pilipinas, 2021a).

| YEAR | TOTAL | TOTAL GOVERNMENT BANKS | TOTAL PRIVATE BANKS | PRIVATE BANKS | | |
|---|---|---|---|---|---|---|
| | | | | PKBs | TBs | RBs |
| 2015 | 100 | 12% | 88% | 70% | 8% | 9% |
| 2016 | 100 | 13% | 87% | 71% | 3% | 12% |
| 2017 | 100 | 12% | 88% | 76% | 3% | 9% |
| 2018 | 100 | 20% | 80% | 77% | 3% | – |
| 2019 | 100 | 21% | 79% | 77% | 2% | – |

*Table 3. Percentage Distribution of Agricultural Production Loans Granted by Type of Bank, Philippines, 2015-2019*
*(Source: PSA, 2020a, p.13)*
*Private banks include: PKBs, TBs and RBs; Government banks include: DBP and LBP only*

BSP reported that the total AFF loans amounted to PHP 263.2 billion in the first quarter of 2020, which shows positive growth in comparison to the PHP 241.2 billion recorded in the first quarter of 2019. Despite a 9.1% improvement, AGRI compliance rates failed to meet the quota required of the Agri-Agra Reform Act or RA 10000, which is at least 15% of the banks' total loan allocation. In fact, they have declined from the previous year's compliance rates as shown in Table 4.

| AGRI-AGRA COMPLIANCE | 2019 Q1 | 2020 Q | GROWTH/ CHANGE |
|---|---|---|---|
| Total compliance for AGRA (in billion PHP) | 58 | 57 | -3% |
| Total compliance for AGRI (in billion PHP) | 653 | 640 | -2% |
| Percentage of compliance for AGRA (required: 10%) | 1% | 1% | -0% |
| Percentage of compliance for AGRI (required: 15%) | 13% | 11% | -2% |

*Table 4. Agri-Agra Compliance*
*(Source: BSP, 2020a, p.4)*

The minimum AGRI compliance requirement was only achieved from the first quarter of 2012 until the second quarter of 2015 (Nuñez, Hordejan & Madamba, 2020). It has since steadily dropped; and by the fourth quarter of 2020, the AGRI compliance rate was recorded at only 9% with PHP 642.4 billion total compliance (BSP, 2021b). In 2020 alone, the compliance rate fell by 18% in spite of the increase in credit allocation, especially from PKBs. Given that the quota is computed based on the total loan allocations, which have rapidly increased due to non-agricultural sectors, financial institutions are still struggling to comply with the minimum AGRI percentage requirement (BusinessWorld, 2019). In fact, banks prefer to pay penalties than lend to the sector (Geron et al., 2016).[4]

## Issues and Challenges in the Implementation of Agri-Agra Law

BSP's Banking Sector Outlook Survey found that, excluding rural and cooperative, banks ranked AGRI-AGRA as the most challenging area in terms of regulatory compliance (2020, p. 21). The low Agri-Agra compliance status can be due to the constraints both in the demand and supply side of financing. In terms of the demand side of financing, agricultural borrowers have limited access to programs that can enhance their technical, financial management and business skills to be able to adopt a business approach to farming. Other than this, environmental risks such as natural calamities, pests and climate change can weigh down farm production, commodity prices and the capacity to pay of farmers (Geron et al., 2016). In November 2013, Typhoon Yolanda damaged crops, property, and infrastructure worth PHP 361 billion or USD 7.5 billion (IFC, 2018). More so, devastation from Typhoon Urduja in December 2017 reached an estimated PHP 1 billion, damaging 23,829 metric tons of farm output, and affecting the livelihood of 38,466 farmers (World Bank, 2018). In a recent study, David Eckstein, Vera Kunzel, and Laura Schafer (2021) ranked countries and

[4] Section 10 of RA 10000 provides that the BSP shall impose penalties on non-compliance with the mandatory agri-agra credit requirement which shall be computed at 0.5%of non-compliance and under compliance and shall be directed to the development of the agri-agra sector. 90% of the penalties collected shall be allocated between the Agricultural Guarantee Fund Pool (AGFP) and the Philippine Crop Insurance Corporation (PCIC) according to the needs of the agri-agra sector, as provided in the IRR of RA 1000, and the remaining 10% shall be given to the BSP to cover administrative expenses.

Consistent with this provision, 90% of the penalties collected by the BSP under RA 10000 are equally remitted to the AGFP and the PCIC while the 10% is retained by the BSP to cover for administrative expenses.

regions which have been affected by impacts of climate related extreme weather events (e.g., storms, floods, heatwaves, etc.). The most affected countries during this period were Puerto Rico, Myanmar and Haiti. They were followed by the Philippines, Mozambique and the Bahamas. The table below illustrates the 10 most affected countries over the period 2000-2019, including the losses in millions, losses per unit GDP.

| CRI 2000-2019 (1999-2018) | COUNTRY | CRI SCORE | FATALITIES | FATALITIES PER 100000 INHABITANTS | LOSSES IN MILLION US $ PP P | LOSSES PER UNIT GDP in % | NUMBER OF EVENTS (2000-2019) |
|---|---|---|---|---|---|---|---|
| 1 | Puerto Rico | 7.2 | 149.9 | 4.1 | 4 150.0 | 3.7 | 24 |
| 2 | Myanmar | 10.0 | 7 056.5 | 14.4 | 1 512.1 | 0.8 | 57 |
| 3 | Haiti | 13.7 | 274.1 | 2.8 | 392.5 | 2.3 | 80 |
| 4 | Philippines | 18.2 | 859.4 | 0.9 | 3 179.1 | 0.5 | 317 |
| 5 | Mozambique | 25.8 | 125.4 | 0.5 | 303.0 | 1.3 | 57 |
| 6 | The Bahamas | 27.7 | 5.4 | 1.6 | 426.9 | 3.8 | 13 |
| 7 | Bangladesh | 28.3 | 572.5 | 0.4 | 1 860.0 | 0.4 | 185 |
| 8 | Pakistan | 29.0 | 502.5 | 0.3 | 3 771.9 | 0.5 | 173 |
| 9 | Thailand | 29.8 | 137.8 | 0.2 | 7 719.2 | 0.8 | 146 |
| 10 | Nepal | 31.3 | 217.2 | 0.8 | 233.1 | 0.4 | 191 |

*Table 5. The Long-Term Climate Risk Index (CRI): The 10 countries most affected from 2000 to 2019 (annual averages)*
*(Source: Eckstein, Kunzel, and Schafer, 2021, p. 13).*

With regard to the supply side of financing, not all banks have the specialized, technical and institutional capacity to quantify, measure and mitigate risks related to agricultural financing. In the case of the agrarian reform sector, banks have difficulty in lending to this sector because the list of beneficiaries is not readily available. Thus, banks find it difficult to find the qualified borrowers for agrarian reform (Geron et al., 2016).

Given the difficulty of bank compliance to meet the mandatory loan allocation to the agri-fishery sector, BSP approved amendments to IRR of the Agri-Agra Reform Credit Act of 2009 or RA 10000 in February 2021. The **main goal of these amendments is to boost lending to the agri-agra sector by broadening how banks can meet the mandatory requirements specified in RA 10000.** In this, BSP explained that the issuance of the amended IRR is timely and positive development since it will assist the sector recover from the impact of the COVID19-pandemic and other natural calamities through enhanced private sector financing. The IRR amendments facilitate the provision of available financing to the sector by providing banks with expanded financing avenues, streamlining banks' process of investing in agri-agra eligible securities, and promoting innovative financing solutions that fall within the ambit of RA 10000 (written correspondence, August 18, 2021).

BSP, DA and DAR identified and implemented four amendments in the law. The first amendment is the removal of the accreditation requirements for debt securities. The new rules removed the current accreditation requirement for that security so that it would be easier for banks to invest, given the fact that they do not have to go through an accreditation process. On the part of the accrediting agency, it frees up their resources so that they can direct these toward other critical services for the benefit of the agri-agra sector (RA 10000 IRR Amendments).

The second amendment is that it allows shares of stock in companies engaged in agricultural activities under Section 23 of RA 8435 or Agriculture and Fisheries Modernization Act (AFMA) as mode of compliance, subject to BSP prudential requirements on the investment. These are the following scope of the Agro-Industry Modernization Credit and Financing Program (AMCFP) under Section of AFMA:

A. Agriculture and fisheries production including processing of fisheries and agri-based products and farm inputs;

B. Acquisition of work animals, farm and fishery equipment and machinery;

C. Acquisition of seeds, fertilizer, poultry, livestock, feeds and other similar items;

D. Procurement of agriculture and fisheries products for storage, trading, processing and distribution;

E. Acquisition of water pumps and installation of tube wells for irrigation;

F. Construction, acquisition and repair of facilities for production, processing, storage, transportation, communication, marketing and such other facilities in support of agriculture and fisheries;

G. Working capital for agriculture and fisheries graduates to enable them to engage in agriculture and fisheries-related economic activities;

H. Agribusiness activities which support soil and water conservation and ecology-enhancing activities;

I. Privately-funded and LGU-funded irrigation systems that are designed to protect the watershed;

J. Working capital for long-gestating projects; and

K. Credit guarantees on uncollateralized loans to farmers and fisherfolk.

Source (RA 8435 AFMA, 2016, p.13)

The third amendment is that it expands modes of compliance for agrarian reform credit within the ambit of RA 10000. The new rules allow financing to members of an ARB household who contribute to productivity of awarded land as eligible direct compliance. In the current RA 10000, banks are only allowed to lend to the agricultural-related borrower and not to the family members. However, in the agrarian reform, the new rules allow banks to lend to family members of an ARB household, which would be considered as compliance. The caveat here, however, is that these family members of an ARB household need to prove that they are indeed contributing to the productivity of the awarded land in order for banks to lend them money. Other than this, the new rules allow financing for agricultural activities that are beneficial for agrarian reform communities as eligible alternative compliance. In the previous IRR of RA 10000, there was no mention of agrarian reform communities (ARCs) but this is something that DAR is currently working on. Therefore, the new rules accept bank financing that is directed to activities benefiting ARCs will be considered as eligible alternative compliance (RA 10000 IRR Amendments).

The last amendment is that it emphasizes special types of lending arrangements allowed under RA10000. The new rules identify other types of lending arrangement which can be considered as eligible alternative compliance. These are:

1. Lending to agribusiness enterprises with supply chain arrangements directly with qualified agricultural borrowers;
2. Agricultural value financing;
3. Palay housing and family homestead (RA 10000 IRR Amendments).

Given these amendments, BSP, DA and DAR are expecting to improve bank lending to the agri-agra sector due to its perceived high cost and risk.

BSP believes that the amendments to the IRR of RA 10000 are expected to further mobilize bank sector financing towards the agricultural, fisheries and agrarian reform sector by addressing challenges identified in the operationalization of the Law. These challenges relate to processing time in the securities accreditation process, difficulty of borrowers in securing agrarian reform credit, limited agri-agra eligible debt securities, and lack of visible bankable projects (BSP, written correspondence, August 18, 2021).

In the same way, LBP fully supports ongoing initiatives to amend the provisions of RA 10000, which will provide farmers and fishers nationwide an expanded and easier access to responsive agricultural financing (LBP, written correspondence, November 10, 2021).

# LBP'S OVERALL LENDING PERFORMANCE IN THE AGRICULTURE SECTOR

The passage of RA No. 3844 or the Agricultural Land Reform Code led to the creation of LBP to finance the distribution of agricultural estates for division and resale to small landholders and the purchase of landholdings by agricultural land tenants. In 1973, the enactment of Presidential Decree (PD) No. 251 made LBP the first universal bank by charter and was granted commercial banking powers in order to cross-subsidize the cost of its agrarian land transfer operations and loans to small farmers. PD No. 251 allowed LBP to grant loans to agricultural, industrial, homebuilding or home financing projects and other productive enterprises. In 1988, under the Comprehensive Agrarian Reform Law (or RA No. 6657), LBP became the financial intermediate of the government's CARP (LBP, 2019a).

LBP plays two important roles: development banking and commercial banking. As a development bank, LBP has a social mandate to provide financial services either directly or indirectly to individual farmers, ARBs and farmers' cooperatives/ associations. As a universal bank, LBP performs both commercial and investment banking functions. This means that the profits generated from its commercial banking operations are used to finance the Bank's developmental programs (LBP, 2018b).

As a financing institution, LBP is one of the country's top five commercial banks in terms of deposits, assets and loans. LBP's performance posted marked growth given the economic impact of COVID-19 pandemic crisis. In December 2020, LBP ranked as the third largest lender in the Philippines in terms of assets worth PHP 2.362 trillion, 16.1% higher from PHP 2.033 trillion in 2019. The LBP deposits reached PHP 2 trillion. In the same way, its capital rose to PHP 168.3 billion, 13% higher from PHP 149 billion in 2019 (LBP, 2020c; LBP, 2020d).

In 2021, LBP's performance improved by having the second largest total assets worth PHP 2,513,573.88 million. Also, it has the second largest total deposit liabilities worth PHP 2,232,452.42 million. Furthermore, LBP ranked as the fourth largest lending institution worth PHP 819,881.26 million (BSP, 2021c). Among government-owned controlled corporations (GOCCs), LBP has been a consistent top earner. In 2019, LBP had the sixth largest income worth PHP 85,116.15 million (Commission on Audit, 2019).

As a government bank, LBP's commitment to provide financial services for farmers and fishers can be seen in the statement of LBP President and Chief Executive Officer (CEO) Cecilia C. Borromeo in 2019. She specifically said, "We at LANDBANK remain steadfast in directing support to our priority sectors, especially farmers and fishers, as we work towards making finance accessible and available to as many Filipinos as possible, especially in the countryside" (LBP, 2019a). Currently, LBP is considered as the largest provider of financial services in rural areas (Department of Agriculture, 2018; Corporate Finance Institute, 2021). LBP is the only bank present in all 81 provinces of the country through an extensive network of 479 branches and branch-lite units as of 30 September 2021. This is complemented by 55 lending centers in strategic areas nationwide, as well as 2,440 ATMs and 216 cash deposit machines (LBP, written correspondence, November 10, 2021).

Other than these facets, the DOF cited LBP as the only universal bank compliant with the provision of the Agri-Agra Law (LBP, written correspondence, November 10, 2021). The regulations states: **"The Agri-Agra Reform Credit Act of 2009 (Republic Act No. 10000) mandates all government and private banking institutions to allocate at least 25% of their total loanable funds for agriculture and agrarian reform beneficiaries (ARBs). Fifteen percent of the loanable funds must be allocated to the agriculture sector and the remaining 10% to ARBs."** The term loanable funds is used to describe funds that are available for borrowing. Loanable funds consist of household savings and/or bank loans. In 2020, LBP's agricultural loans were worth PHP 237.62 billion. This accounts for 26% of loanable funds and puts the bank in compliance.

In this case, it is important to take note that percentage compliance is a calculation based on a comparison of the agriculture proportion of the loanable funds / gross loans (e.g. the 26.5% LBP mentions), and the required compliance value (25%). Comparing these two values, there is a 106% compliance. More than 100% compliance means that they are providing a larger proportion of their loanable funds to agriculture than required to do so under Agri-Agra. Less than 100% means that they are not fully compliant (i.e., a sufficient proportion of their loanable funds is being provided to agriculture). However, the researcher has not yet found a breakdown anywhere of their Agricultural loans versus their Agrarian reform loans.

## ARBs' Perspectives on LBP Lending Performance

Despite LBP's efforts to reach the unbanked and underserved areas through its programs, farmers in Mindanao are still struggling in agricultural financing. This study surveyed 23 ARBs in Davao De Oro in the Davao Region. The survey result revealed that 22 ARBs said that they find it hard to support their own farm due to limited income. According to the 2020 PSA report, a Davaoeño needed PHP 2,159.00 in 2018 to meet his/her monthly basic requirements to stay out of poverty (PSA, 2020b). Unfortunately, the figure below shows that 26% of ARBs answered that their household monthly income is PHP 500-2999 which is already beyond the poverty income threshold in the area. It is also worth noting that the highest household monthly income of some ARBs surveyed for the research is only more than PHP 10,000.00, even if the majority of them have been into farming for almost 14 years.

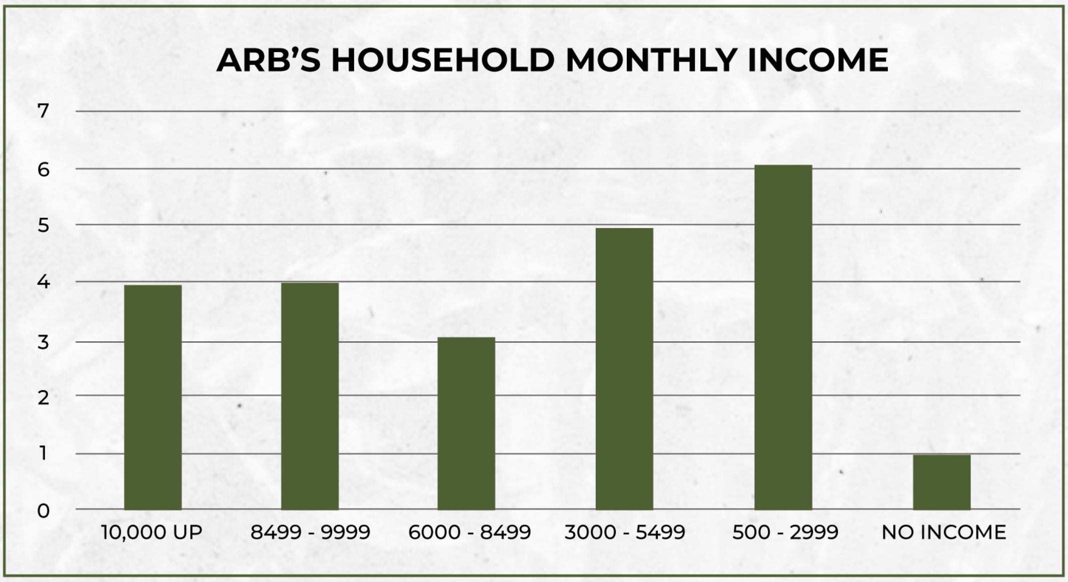


*Figure3. 23 ARBs' Household Monthly Income in Davao De Oro in the Davao Region*

Figure 3 shows that one ARB female said that she does not have any income at all in the present period. Her total loan was Php400,000.00 which she obtained from different institutions such as LBP, Trubank of Compostela and informal lending. She needed the money for her to rehabilitate her land area which was infested by Panama disease. It is important to take note that she is separated and she has one son under her care. The survey also revealed that 14 ARBs have existing loans from different institutions. Majority of them rely on banks and lending in order to obtain the needed loans for their personal use and for farm support. However, they said that it is easier to borrow money from informal lending and not banks. This is because passbook is the only requirement for informal lending in their area. Other than this, FAO's (2016) study notes that there is natural aversion among farmers and ARBs to seek loans from formal sources.

Another major finding in the survey is that all 23 ARBs did not receive any form of support from LBP during this time of COVID-19 pandemic. All of them said that LBP had not yet reached out to them for seminars/ training/programs on financial inclusion and online banking. In the case of farm production, the majority of them said that COVID-19 did not affect their farm operation. Nevertheless, it negatively affected some of them, who had sideline jobs given the limited movement in the area.

Lastly, the survey revealed that Davao Fruits Banana Growers Agrarian Reform Cooperative (DFBGARC) members had a group loan under Agrarian Production Credit Program (APCP)[5]. This also transpired in the 2020 IDEALS case study entitled Agribusiness Venture Arrangements (AVAs) as a Collateral Substitute. In 2012, Typhoon Pablo devastated most banana plantations in Compostela Valley. One of the affected ARB cooperatives was DFBGARC. They applied for a group loan under APCPC amounting to Php7,518,000.00 with 9.5% interest rate per annum. In this case, LBP used the grower-ship agreement[6] of DFBGARC with Sumifru as a collateral substitute in order to reduce the risk of loan defaults which is a common issue among farmers in terms of credit (IDEALS, 2020).

It is important to note that this research used Binswanger, et al.'s (1986) definition of collateral substitute. Binswanger et al. defined collateral substitutes as non-physical assets with or without a market

[5] APCP is a credit facility designed to meet the financing needs of ARBOs and their member-ARBs. The program has two major objectives: 1) to increase ARBOs and ARBs' access to credit and 2) to improve their capacities (Agrarian Production Credit Program, 2021).

[6] Growership agreement is a type of AVAs. Under this agreement, ARBs grow crops and sell the product to a large company at pre-arranged items.

value, or physical assets that have qualities other than collateral to enforce loan repayments. One of the examples of collateral substitutes is interlinked contracts. In this case, the agribusiness venture arrangements (AVAs)[7] of some agrarian reform beneficiary organizations (ARBOs) were used as an interlinked contract for farm rehabilitation loans in 2012. The AVA of DFBGARC was used as one of the pre-release conditions of their loans (IDEALS, 2020).

Further, as a pre-release condition, LBP Tagum required the submission of a tripartite agreement between LBP, Sumifru and DFBGARC facilitated the process of loan payments. The agreement is tripartite because LBP necessitates the involvement of a corporate partner before approving the loan and releasing any funds to the farmers. Under the agreement, Sumifru as buyer/investor is obligated to assist the farmers in the rehabilitation of their farm. Sumifru is also obligated to endorse the farmers availing of the loan to LBP and help the bank collect payments and process any documents needed upon request of the bank (IDEALS, 2020).

Hence, DFBGARC members surveyed for the study said that the payment process was easy because Sumifru would deduct loan payments from their production proceeds. In terms of the application process, they said that it was very difficult for them to apply for the loan due to several requirements. Some of these requirements indicated in the survey were Gross Sales Liquidation, Certification from Sumifru and co-maker.

In addition to this, LBP used reserve funds as a safeguard mechanism in the event of farm rehabilitation loan default of DFBGARC. An Account Officer of LBP-Davao Del Norte Lending Center explained that this is one of the advantages of tripartite agreement because the reserve funds can be used as a source of savings for the farmers and ARBOs. Reserve funds are also used when expected cash flow of the individual farmer- borrower falls short to service loan amortization amount on a specific due date. The LBP account officer further purported that the tripartite agreement on financing with the bank and the corporate investor of the ARBOs is not exclusively done by LBP. This is also being practiced by other banks. The main purpose of this agreement is to avoid loan defaults which are a common issue among farmers (IDEALS, 2020).

It should be noted there are problematic provisions in the grower-ship agreements of DFBGARC with Sumifru. One of these is that the current buying price is fixed at USD 4.25 without regard for inflation

[7] AVA refers to entrepreneurial collaboration between agrarian reform beneficiaries (ARBs) and investors to implement an agribusiness venture involving lands distributed under CARP (Sec.3.2, DAR AO 9 of 2006).

and other changing conditions. While lengthy contract periods under the AVAs in themselves are not problematic, they become problematic in this case because they are used to bind the farmers to the onerous provisions of the contract for a long period of time. Another problematic provision is the takeover clause, the dangers of which have been discussed above. The major concern on the takeover clause is the vague conditions for the takeover; the phrase "other similar situations" makes it possible for Sumifru to exploit any situation in order to justify a takeover. Most importantly, the contract does not provide any grievance procedure, thereby making the power of Sumifru to affect the takeover. Such provision directly negates the essence of CARP, which is to allow ARBs to gain control over their economic resources (IDEALS, 2020).

In 2021, the researcher communicated with LBP's National Office, specifically the Strategy and Knowledge Management Group, to inquire regarding LBP's agricultural financing. The researcher asked regarding LBP's use of AVAs as collateral substitutes. In response to this, LBP pointed out that the Bank does not use AVAs as collateral substitutes for its loan programs (including APCP). Under APCP, lending to small farmers and fishers is through their respective organizations and other eligible conduits. AVA is not among the loan collaterals being required under the program (LBP, written correspondence, November 10, 2021). Loan collaterals and credit enhancers include the following:

1. Chattel Mortgage on the object of financing (if applicable)
2. Assignment of sub-borrowers' promissory notes, plus underlying collaterals
3. Assignment of PCIC insurance proceeds, guarantee claims, hold-out on deposit (if any)

From this, one can infer that there seems to be a disconnect in terms of how LBP loan programs—specifically APCP—are being implemented on the ground. According to LBP, it does not use AVAs as a collateral substitute for all its loan programs for farmers. However, according to the IDEALS case study in 2020, it revealed that the LBP branch in Tagum has been using AVAs as a collateral substitute not only under APCP but also under the Rehabilitation Program for Cavendish Banana Production. The 2020 IDEALS study examined three ARB cooperatives and their respective loans from LBP. The LBP branch in Tagum confirmed that it required the ARBs to extend the length of their AVA with Sumifru so that the termination date matches or exceeds the loan repayment term. Under this set up, the process of loan payment is easy. The company would automatically deduct the payment of ARBs from their produce. In return, the bank would be the one to lend money to ARBs in order to support their farm production.

It should be noted that the implementation of AVAs has been quite problematic. A study prepared by FAO and commissioned by the Department of Agriculture (DAR) had comprehensive objectives that considered the agricultural productivity of lands devoted to AVAs among others. The study found that many ARBs involved in AVAs have been suffering due to unfair agribusiness ventures (FAO, 2016; OXFAM, 2016). Most ARBs are unaware of their obligations and rights under the contracts because they are often written in English (FAO, 2016). This also transpired in OXFAM's (2016) study where it was revealed that banana farmers in Mindanao were still suffering due to unfair AVAs. The contract period is typically 15-30 years with automatic renewal for the same length of time or renewal at the sole option of the corporate investor. These extremely lengthy periods provided little to no opportunity for adjustment despite changing conditions (OXFAM, 2016). Currently, there is no law which governs the AVA implementation. Thus, there are cases wherein the farmers and the private investor already started their AVA even without the approval from the national government, specifically DAR. Therefore, banks like LBP should be conscious and selective in using AVAs as collateral substitutes to extend loans to farmers.

# RECOMMENDATIONS AND CONCLUSIONS

There are some recommendations to improve LBP's lending performance in the agriculture sector. First, the study recommends that banks like LBP to be conscious and selective in using AVAs as collateral substitutes. The implementation of AVAs has been quite problematic due to lack of government regulation. Currently, there is no law which governs the AVA implementation in the country. Thus, there are a number of unfair AVAs being implemented even without DAR approval. Given this, it is important for LBP to examine the AVAs. According to the 2020 FFP study, the LBP branch in Tagum explained that AVAs should be monitored and regulated by DAR as the implementing agency.

Another recommendation of this study to improve farmers' access to bank credit is for LBP to translate its general information in different languages. Also, it would be better if the terms and conditions of LBP are also translated in local languages to increase accessibility of communities. In doing so, farmers would be able to understand and be encouraged to get their loans from a formal source such as LBP.

Lastly, the study believes about the important role of development organizations in addressing the demand and supply side constraints in agricultural financing. On the demand side, development organizations like non-government organizations (NGOs) can help to provide training in financial literacy for farmers in order to reduce the riskiness of farmers as borrowers. Some specific training topics can focus on budgeting and on their roles and responsibilities as financial borrowers. On the supply side, development organizations can help financial institutions in assessing the risks associated with farmers. In doing so, they can develop financial products specifically designed for them.

In conclusion, LBP is compliant in agricultural loans, but not in agrarian reform loans. After reviewing LBP's financial statements, the research has not yet found a breakdown regarding their agricultural loans and their agrarian reform loans. From this, one cannot deny the fact that rural finance is still a major concern in the country. This means that there are so many things to be done in order to improve the country's agricultural financing. Most importantly, there is a role for development organizations like NGO in addressing the constraints in agricultural financing. As mentioned, NGOs can provide training sessions/ workshops in financial literacy for farmers and fisherfolk so as to avoid loan default.

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