

# The Regulation of Deposit-Taking Cooperatives\*

*"Ubinam gentium sumus?"\*\**

*Gilberto M. Llanto*

## Accepting as deposits (poor) people's money

The cooperative sector has grown in number and resources in the last few years. In 1990, 4,744 cooperatives registered with the Cooperative Development Authority (CDA). By 1997, as many as 45,721 have been registered with the CDA. While there are no aggregate figures available on their total resources, one notes that several credit cooperatives have total assets ranging from

-----  
\*This draws on Lee Arbuckle, Rescina Bhagwani, Gilberto Llanto and Ma. Piedad Geron "Review of the Regulatory Environment for Credit Cooperatives and Multi-Purpose Cooperatives with Large Credit Operations," a report submitted to the National Credit Council, Department of Finance, Credit Policy Improvement Program, November 1998.

\*\*"Where in the world are we?"

<sup>1</sup>Thirty eight credit cooperatives reported assets ranging from P15 million to P60 million as of July 1998. CDA data on reporting credit cooperatives covered only 10 of 16 regions in the country.

P15 million to P60 million. These figures dwarf the resources reported by some rural banks.<sup>1</sup>

An important subset of the cooperative sector is that of the credit cooperatives and multi-purpose cooperatives which take deposits. For the purpose of this Notes, they are lumped together into what is known as *deposit-taking cooperatives*.

Deposit-taking cooperatives (DTCs) have custodial responsibility over the deposits that members place with them. This is not a light matter especially because the members of DTCs come from the low and middle income classes. And DTCs raise millions of pesos of deposits from small savers. It is not clear, however, whether there is effective regulation to protect the interest of these savers.

## Inconsistent objectives leading to inconsistent roles

Congress, through Republic Act 6839, created the Cooperative Development Authority (CDA) to promote, develop and regulate cooperatives. The law gave expression to the Constitutional mandate for Congress "to create an agency to promote the viability and growth of cooperatives as instruments for social justice and economic

*PIDS Policy Notes* are observations/analyses written by PIDS researchers on certain policy issues. The treatise is wholistic in approach, and like the PIDS Executive Memo, it aims to provide useful inputs for decisionmaking.

The author is Research Fellow at the Institute. The views expressed are those of the author and do not necessarily reflect those of PIDS or any of the study's sponsors.

development" (Section 15, Article XII, 1987 Constitution). At the same time, Congress assigned a regulatory function to CDA.

In carrying out its mandate, CDA focused more on discharging its developmental role, and gave minor attention to sound registry and regulation of active cooperatives. For its developmental role, CDA conducts management and training programs for cooperatives and provides them with financial assistance through grants, donations and subsidized loans. What the CDA perceives

"With so many registered cooperatives needing "developmental" assistance, the CDA faces the daunting task of assisting those cooperatives to the detriment of efficient registry and regulation."

to be its main regulatory function is the registration of cooperatives, federations and unions. Thus, the emphasis seems to have been on accommodating the huge number of cooperatives seeking registration.<sup>2</sup> Little attention has been given to the cancellation of registration of those cooperatives that do not file their annual reports and audited financial statements. No attention has been given at all to monitoring the financial health of thousands of deposit-taking cooperatives that mobilize savings from the low and middle income classes.

Because of low barriers to entry, e.g., minimum capital required for a cooperative wanting to be registered is a measly P2,000.00, and the attractive tax and other incentives waiting a registered cooperative, as many as 45,721 cooperatives have been registered with CDA

<sup>2</sup>The inaction of the CDA on an application within 30 days constitutes an approval of the same. Denial of application may be appealed to the Office of the President of the Philippines. If not acted upon within 90 days, the application concerned will be deemed approved.

as of end of 1997. With so many registered cooperatives needing "developmental" assistance, the CDA faces the daunting task of assisting those cooperatives to the detriment of efficient registry and regulation.

The developmental role conflicts with the regulatory role. The case of the (defunct) Central Bank of the Philippines offers a clear example of the difficulties of institutions with inconsistent objectives leading to inconsistent roles. The Central Bank faced the dilemma of efficiently supervising and, at the same time, regulating banks and providing them with development finance. The inconsistency was resolved by making the Central Bank concentrate on its regulatory function and handing over to government financial institutions the task of providing development finance to private banks.

In the case of CDA's posture toward deposit-taking cooperatives, the development function of organizing and providing technical assistance to cooperatives conflicts with the registry and standard-setting functions. This produces an organization, i.e., the CDA, that is ambivalent in its objectives, role, and function.

### The challenge to policymakers: which way is it for the CDA?

It is difficult and probably impossible for the same organization to carry out well two different and inconsistent functions. For the CDA as an organization, it is difficult to discharge both the developmental, and registry and regulation functions of deposit-taking cooperatives.

Registry and regulation, on the one hand, are mutually-reinforcing responsibilities assigned by law to the CDA. Because of well-known information asymmetry problems in the financial market that give rise to moral hazard problems, the state normally assigns a regulator to protect depositors and investors in financial institutions. This holds true for the CDA.

On the other hand, the development function is not an indispensable role for the CDA. The record and the experience, for instance, show that government's involve-

ment in the "organization and development" of cooperatives has created perverse incentives on the part of the organized cooperatives. Recent field findings<sup>3</sup> as well as results of past studies indicate that many cooperatives that were organized for the sole purpose of receiving subsidized, directed loans have long closed shop. Those cooperatives have either disbanded or have become inactive after getting subsidized loans from government or government financial institutions. So much for the government's "developmental" role in the cooperative sector.

There are options for the CDA with respect to the developmental function. Following the principle of subsidiarity, the CDA can delegate this function to well-selected cooperative federations and unions. It is the good fortune of the cooperative sector that there are privately-organized cooperative federations and unions that have proven their skill and experience in the promotion and development of cooperatives.

Of much more importance for the state, especially to depositors, is the effective regulation of deposit-taking cooperatives. The Bangko Sentral ng Pilipinas supervises and regulates banks. While the CDA has been tasked to regulate DTCs, it is not doing a good job at it. CDA can thus concentrate on regulating the financial intermediation activities of deposit-taking cooperatives.

## Reinforcing the market


There are several thousand credit cooperatives and multi-purpose cooperatives that take deposits. As such, it would be a very tough job for the CDA to perform an effective oversight function unless it adopts appropriate measures to reinforce regulation by the market. With timely and correct information about credit cooperatives,

"With timely and correct information about credit cooperatives, members and customers themselves can vote with their feet, in a manner of speaking, by rewarding safe credit cooperatives with more deposits, thereby allowing these organizations to generate more business and profits for members."

members and customers themselves can vote with their feet, in a manner of speaking, by rewarding safe credit cooperatives with more deposits, thereby allowing these organizations to generate more business and profits for members. In a way, this is the most powerful form of regulation and only with the availability of correct and timely information

can this be successfully achieved.

The CDA's role in providing access to timely and correct information is therefore critical. This could be done by setting standards, imposing a uniform chart of accounts and accounting rules, requiring the submission of audited financial statements and showing a lot of seriousness in canceling the registry of erring cooperatives.<sup>4</sup> At the same time, it could collaborate with the Bangko Sentral ng Pilipinas, the Philippine Deposit Insurance Corporation and the various federations and unions of credit cooperatives in harmonizing regulatory policies.

Only with the above can the CDA truly exercise its mandate of regulation over DTCs. 

<sup>3</sup>Arbuckle et al. (ibid.) and Gilberto M. Llanto, "The Financial Structure and Performance of Philippine Credit Cooperatives." Discussion Paper No. 94-04, Philippine Institute for Development Studies, 1994.

<sup>4</sup>CDA registration is a precious commodity. Without it, a cooperative would not be able to enjoy various tax perks and incentives, e.g., subsidized loan from CDA.

*For further information, please contact*

The Research Information Staff  
Philippine Institute for Development Studies  
NEDA sa Makati Building, 106 Amorsolo Street  
Legaspi Village, Makati City  
Telephone Nos: 8924059 and 8935705;  
Fax Nos: 8939589 and 8161091  
E-mail: gllanto@pidsnet.pids.gov.ph,  
jliguton@pidsnet.pids.gov.ph

## List of PIDS Discussion Papers for 1998\*

98-12	Metro Iloilo: A Struggle for Acceptance and Organization (Revised) <i>Ruben G. Mercado and Raul S. Anlocotan</i>	98-26	Productivity Growth in the Philippines After the Industrial Reforms <i>Myrna S. Austria</i>
98-13	Metropolitan Naga: A Continuing Challenge of Local Autonomy and Sustainability (Revised) <i>Ruben G. Mercado and Victor B. Ubaldo</i>	98-27	The Emerging Philippine Investment Environment <i>Myrna S. Austria</i>
98-14	Providing a Metropolitan Perspective to Development Planning: Cagayan de Oro (Revised) <i>Ruben G. Mercado and Casimira Balandra</i>	98-28	Beyond 2000: Assessment of Economic Performance and an Agenda for Sustainable Growth <i>Josef T. Yap</i>
98-15	Metropolitan Cebu: The Challenge of Definition and Management (Revised) <i>Ruben G. Mercado</i>	98-29	In Search of Metropolitan Definitions: Lessons from Metro Davao <i>Ruben G. Mercado</i>
98-16	Owning the Metropolitan Vision: The Case of BLIST (Revised) <i>Ruben G. Mercado and Carmel P. Chammag</i>	98-30	Megalopolitan Manila: Striving Towards a Humane and World Class Megacity <i>Ruben G. Mercado</i>
98-17	Financing and Delivery of Health and Sanitation Services through Effective Resource Mobilization and Inter-governmental Coordination: A Case Study of Cotabato City (Revised) <i>Virginia S. Pineda and Ma. Lourdes Lim</i>	98-31	Metropolitan Arrangements in the Philippines: Passing Fancy or the Future Megatrend? <i>Ruben G. Mercado and Rosario G. Manasan</i>
98-18	People Power at Work: The Case of the Surigao City Primary Health Care (PHC) Federated Women's Club (Revised) <i>Virginia S. Pineda and Jazmin Berido</i>	98-32	Environment and Natural Resources Management: Lessons from City Program Innovations <i>Ruben G. Mercado</i>
98-19	Emergency Rescue Naga: An LGU-Managed Emergency Rescue Project (Revised) <i>Virginia S. Pineda and Rose Buan</i>	98-33	The Case of Butuan City: A Consistent Regional Outstanding Winner in Nutrition (CROWN) <i>Virginia S. Pineda and Jazmin D. Berido</i>
98-20	Puerto Princesa City's Satellite Clinics: A Curative Rural Network (Revised) <i>Virginia S. Pineda</i>	98-34	Olongapo: A Healthy City <i>Virginia S. Pineda and Aurora Joson</i>
98-21	Reaching Out: Gingoog City's Total Integrated Development Approach (G-TIDA) (Revised) <i>Virginia S. Pineda and Clark Clarete</i>	98-35	Partnership for Health: A Case Study of Lapu-lapu City <i>Virginia S. Pineda</i>
98-22	The Low-Cost Housing Program of Puerto Princesa City, Palawan <i>Anicia C. Sayos and Antonio C. Fernandez</i>	98-36	Health Management: Strategies from Selected Cities <i>Virginia S. Pineda</i>
98-23	The "Lote Para sa Mahihirap" Housing Program of San Carlos City, Negros Occidental <i>Anicia C. Sayos and Estela F. Paredes</i>	98-37	Financing and Delivery of Urban Services in the Philippines: An Overview <i>Rosario G. Manasan</i>
98-24	"Kaantabayan sa Kauswagan" (Partners in Development) Mass Housing Strategy: The Case of Naga City <i>Anicia C. Sayos</i>	98-38	Water in Metro Cebu: The Case for Policy and Institutional Reforms <i>Cristina C. David, Arlene B. Inocencio, F. M. Largo and E. L. Walag</i>
98-25	The International Economic Environment and the Philippine Economy <i>Ponciano S. Intal, Jr. and Leilanie Q. Basilio</i>	98-39	Towards an Efficient Path to Food Security: The Philippine Case <i>Cristina C. David</i>
		98-40	Developing an Early Warning System for BOP and Financial Crises: The Case of the Philippines <i>Josef T. Yap</i>
		98-41	Understanding Household Water Demand for Metro Cebu <i>Francisco M. Largo, Arlene B. Inocencio, and Cristina C. David</i>
		98-42	A Study of Housing Subsidies in the Philippines <i>Gilberto M. Llanto, Aniceto C. Orbeta, Jr., Ma. Teresa C. Sanchez and Marie Christine G. Tang</i>

\*Discussion papers are studies that are preliminary and subject to revisions. This listing consists of discussion papers released from October to November 1998.