SECTOR ASSESSMENT: MICROFINANCE

A. Overall Sector Context

1. **Poverty Reduction Objectives and Measures.** About 72% of the population is living in rural areas of Viet Nam where 94% of the nation's poor also lives. In rural Viet Nam, agriculture, which accounts for 54% of the national workforce, is the economic mainstay. Government's national poverty reduction program is thus focused on modernizing agriculture and value-added agro-processing; promoting non-farm household businesses; and increasing employment opportunities through geographically dispersed industrialization and small and medium enterprise (SME) promotion. The results have been remarkable, with poverty reduced from 58% in 1993 to 12.3% as of end 2009 and Viet Nam is poised to meet its Millennium Goal by 2015. However, poverty distribution remains skewed with 45% of the poor accounted by ethnic minorities in remote areas, while they comprise only 14% of the population. Among the major constraints in achieving program objectives is the lack of responsive and adequate microfinance services.

2. **Dual Approach to the Microfinance industry**. In response to the needs for easing the financing constraints for the poor and rural households, the government has adopted a dual approach that is both market-based and state-driven. Thus, a mixed network of microfinance operating financial institutions has steadily been developed since the advent of *Doi Moi* to cater to the rural and low-income groups. Currently, two state-owned financial institutions, comprising the market-oriented Viet Nam's Bank for Agriculture and Rural Development (VBARD) and the heavily subsidized non-profit Viet Nam Bank for Social Policies (VBSP) coexist with about 1,040 member-based People Credit Funds and some 50 semi-formal micro finance institutions (MFIs) that are mainly supported by mass organizations and donors.

3. **Microfinance Sector Policy and Regulatory Environment.** In 2005, the government issued Decree 28 that allowed the transformation of semi-formal MFIs into licensed credit institutions (CIs), regulated and supervised by the State Bank of Vietnam (SBV). However, the law was too restrictive even after it was amended by Decree 165 and Circular 2 issued in 2007, mainly due to limits set on ownership. In June 2010, the new Credit Institutions Law (CIL) was passed. It is a landmark legislation that fully integrates the microfinance sector into the formal financial system, including much improved provisions for creating and regulating MFIs, PCFs, cooperative banks, and the supervision of policy banks. It also liberalized interest rates, allowing these to be fixed or negotiated between CIs and their clients. Pro-poor innovations are also incorporated in the new CIL and various SBV circulars, such as those relating to: (i) micro-insurance; (ii) e-banking that will allow affordable and safe mass-based IT-enhanced financial services; and (iii) customer protection, e.g., deposit insurance, prohibition on illegal actions, transparency on interest rates, customer rights and responsibilities, and daily transaction limits.

B. Overall Microfinance Sector Performance.

4. The performance of the microfinance sector in recent years appears remarkable at first glance with a diverse set of microfinance service providers and showing rapid growth in coverage over the last five years. However, the cause of the growth is highly skewed towards micro-credit delivery and government intervention through VBSP. VBSP and VBARD are now the most dominant players accounting for almost 87% of micro-borrowers (VBSP – 62%) and 88% of loans outstanding (VBSP – 49%). As of end 2010, VBSP lent to 7.8 million household (HH) borrowers, 3.8 million of which are reportedly poor. This was made possible by its credit

delivery scheme through 200,000 credit and savings groups (CSGs) formed with the support of People's Committees and mass organizations at the commune level (see Table 1 below).

Table1: Profile of Micro-credit delivery in Viet Nam

Institution	Number (million)	% to Total	Loans (US$ M) Outstanding	% to Total
VBSP[a]	7.8	62%	4,398	49%
VBARD[b]	3.2	25%	3,500	39%
PCFs[c]	0.95	7%	1,006	11%
MFIs/NGOs[d]	0.6	5%	75	1%

Sources: [a] VBSP Report, as of July 2010; [b] VBARD report, as of 31 October 2009, [c] Central Credit Fund Annual Report 2009; [d] As of end 2009. Viet Nam Microfinance Bulletin, July 2009.

5. **Remarkable Gender Orientation.** As of end 2008, about 94% of active microfinance clients in Viet Nam were female. Most MFIs and NGO microfinance programs have near or 100% female clients. Likewise, a disproportionate majority (if not all) of MFIs and NGO microfinance programs in Viet Nam are run by women. VBARD, VBSP and PCFs also maintain a quite high proportion of female clients. VBSP partners mainly with local Vietnam Women's Union (VWU) in client selection, and in forming and managing CSGs.

6. **Micro-savings services.** VBARD is the leading deposit mobilizer accounting for 54% of close to a million rural savers in the banking system, followed by VBSP with about 22% share although the latter covers 98% of all communes. The PCFs only cover 10% of the communes and have 15% share of depositors, while the NGO-MFIs that mainly mobilize compulsory deposits linked to their loans and are still minor players with 4% of total.

7. **Remittances, payment systems and other services.** All banks in Viet Nam offer a wide range of financial products, including money transfers, ATM services, foreign currency exchange, credit and debit cards, etc. Major remittance companies, such as Western Union and Money Gram provide cash transfers, often with banking tie-ups, and the post offices – where the Viet Nam Postal Savings Bank (VPSC) is strategically located. The competitive environment makes these services reasonably accessible and affordable to poor households, but not necessarily in rural areas. The Central Credit Fund (CCF) and 8 People's Credit Funds (PCFs) are pilot testing the "Rural-Urban Connectivity Project".

8. **Microinsurance.** Existing laws allow small-scale financial institutions like PCFs and MFIs to be agents of insurance companies, with a few local insurers already offering both life and non-life products targeting low-income groups. Some informal MFIs with external partners (e.g., ILO, RIMANSI, Action Aid) have also pilot tested Mutual Aid Funds (MAFs) that were proven successful in other countries. The Mutual Assistance Insurance (MAI) can be established to provide formal insurance services under the supervision of the Insurance Supervisory Authority, the Ministry of Finance (MOF).

9. **Regulation and Supervision.** The State Bank of Vietnam's (SBV) supervision program and standards have been vastly improved over the past years. SBV consolidated its bank supervision and examination units at the head office into the Bank Supervision Agency (BSA), with special units focusing on commercial banks, non-bank financial institutions, PCFs/CCF, and MFIs. Licensing and on-site bank examinations are decentralized to SBV Regional Offices.

C. Core Sector Issues, Causes and Effects

10. **The poor still lacks adequate microfinance services.** With 72% of the total population, and host to 94% of the poor, rural Viet Nam is estimated to receive only 17% of total bank credit and less that 20% of the rural population has access to formal financial services. Also, VBSP's dramatic growth in micro-credit deliver with the direct intervention and subsidies of government can crowd out the more diverse and market-oriented microfinance providers. This will limit the choices of the vast majority of the rural poor in accessing wider range of sustainable and responsive financial services including credit, savings, money transfer and microinsurance.

11. **Enabling Policy and regulatory framework in place but lack the implementation measures**. While the new CIL has been recently passed, there is still need to craft the implementing rules and regulations (IRR) specific to the microfinance operations. For now, there is not a set prudential and performance standards that will level the field for regulating existing and potential players, such as VBSP, the PCFs and the emerging MFIs. Likewise, licensing requirements for MFIs have yet to be aligned with the new CIL while the current process is slow and needs improvement. Fiscal and regulatory incentives need to be explored to promote the entry of other CIs into microfinance instead of resorting to direct government intervention through subsidized credit schemes. And while the Manual for Supervision and Examination for microfinance-oriented CIs have already been drafted, it has yet to be approved for roll out. Lastly, the IRRs for pro-poor innovations particularly for IT enhanced banking services that can lower transaction costs for the rural poor and mass clients still need to be drawn up.

12. **Inadequate regulatory and supervisory capacity.** There is lack of qualified supervisors and examiners specialized in microfinance operations within SBV, and more so among the relevant government agencies (e.g., MOF, the Ministry of Planning and Invetment) that exercise oversight functions over VBSP, CCF and the PCFs. The need will be even more urgent with the planned expansion of PCFs in size and number, the entry and expansion of licensed MFIs, and the entry of commercial banks with IT-enhanced banking services that will make the microfinance market an even more lucrative niche for business expansion.

13. **VBSP subsidies have marginal impact yet fiscal burden is increasing**. The direct financial benefit of VBSP's subsidized micro-loans to the borrower household (HH) is estimated at only D34,000 per HH per month, (or 0.7% of an average monthly household income) relative to market-based micro-loans offered by other microfinance providers. This cannot justify the increasingly heavy fiscal burden borne by government in terms of equity and loan infusion, direct subsidies, and ODA funding to VBSP which was estimated to grow at an annual average rate of 27% from 2003–2009 and has accumulated to about D23,360 billion ($1.2 billion) as of end 2009, or 1.4% of GDP. The total subsidies and indirect costs due to opportunity costs, foreign exchange losses and income tax/fees forgone for 2004–2009 are estimated at $807 million. VBSP is also shown to incur a perpetual funding gap due to a mismatch in maturities of its clients' loan and its own borrowings, especially as it expands its social policy lending.

14. **The need for an independent and autonomous CCF.** About 98% of the CCF's chartered capital of D1.36 trillion ($73 million) is owned by the government that also guarantees most of its loans and governs its operations. Close to 50% of the CCF's loan portfolio is outside of the PCF network, with loans to state-owned enterprises (SOEs), SMEs, and other entities which are non-members of PCFs. CCF should strengthen its alliance with PCFs through increased ownership of and services to them so as to effectively support the PCF system as an apex institution, following the globally-proven and widely-accepted cooperative good practices.

15. **PCFs have weak member base**. As of end 2009, PCFs' total members stood at 1.7 million, or an average of about 1,700 members per PCF. PCFs were set up on a "one-commune-one-PCF" principle, limiting their growth. However, a more complex reason suggests that the number of *true members* of the PCFs could be far smaller and that PCFs generally operate more like closely owned and controlled rural banks rather than traditional member-based financial cooperatives. Typically, a PCF has less than 50 "core-members", usually of higher-income HHs – that provide "core-capital' of D2.5 million to D250 million ($220 – $2,200) each. They form the board and can set barriers to entry for new core members, with a tight control of operations. PCFs should be encouraged to expand member-based operations with an improved governance.

16. **Majority of MFIs are weak.** The development of microfinance institutions (MFIs) had been constrained until recently by the lack of legal and regulatory framework for licensing and formalizing these. Over the last 2 decades, only one MFI has attained an outreach of over 130,000, 2 with around 40,000, and 3 with about 20,000 clients as of end 2010. These 6 MFIs account for over 60% of the clients of the top 50 MFIs. The government, with ADB assistance, has prepared the legal and regulatory framework to formalize and license MFIs under SBV, allowing them to take deposits under the prudential norms for credit institutions. So far, 2 MFIs – TYM and M3, leading MFIs, were granted SBV licenses with several others applying for such license. Formalizing and licensing MFIs under SBV will improve their governance structure and strengthen their capacity to offer a range of financial services and ably compete with formidable microfinance players, such as: a reformed VBSP, strengthened PCFs supported by a cooperative bank (transformed from CCF), and credit institutions/banks that are likely to provide information technology (IT) enhanced microfinance services.

17. **Inefficient financial infrastructure**. There is no systematic credit information exchange. Lack of effort in promoting financial literacy and customer protection and under-developed training institutions and modules should be addressed for the microfinance sector development. As the sector develops, systemic and geographical risks will be growing concerns due to potential overlaps among microfinance players and over-financing of clients in more populated areas. This will need a cost-effective credit information exchange system. A larger number of microfinance players will also mean greater demand for qualified management and staff. Currently, microfinance training opportunity is limited, while the microfinance industry will increasingly need to enhance their capacity. Consequently, there will be growing concerns for client protection and the overall safety and stability of the sector operations.

D. Government Sector Strategy, Policy and Plans

18. **Implementing the enabling policy and regulatory framework.** Overall, the new CIL has set the broad legal and regulatory framework for developing a robust and responsive microfinance sector. However, many of the IRRs for the CIL still need to be drafted and approved. The CIL involves key provisions on microfinance operations, including (i) licensing and reporting requirements of MFIs; (ii) prudential ratios for small scale institutions; (iii) transitional provisions for unregulated MFI and microfinance programs; (iv) various provisions on PCFs and cooperative banks; (v) provisions for the policy banks to be subject to the reporting and internal control standards of SBV; (vi) credit classification and provisioning standards applicable to MFIs; (vii) broad guidelines on e-banking; and (viii) provisions on customer protection (e.g., deposit insurance, transparency, client literacy, etc.).

19. **Implementing the National Microfinance Strategy and entity-specific strategies.** The Viet Nam Microfinance Development Strategy (the National Microfinance Strategy) for 2011-2020 was approved by the Prime Minister in December 2011. Entity-specific strategy and roadmap for CCF/PCFs is also approved, and that for VBSP is in the process of approval, and combined with the National Microfinance Strategy these will aim for: (i) enhancing the supervisory and regulatory capabilities of SBV over the sector through recruitment, training and further streamlining of procedures; (ii) studying incentive options to promote credit instituions' entry into microfinance; (ii) transformation of VBSP towards self-sufficiency, market-orientation and deepening of services; (iii) conversion of CCF into a cooperative bank to be owned and be the banking hub of an expanded PCF network (from 1,040 small commune-level PCFs to 1,700 intra-commune PCFs) based on cooperative best practices; and (iv) improving the support infrastructure by expanding the role of Banking Academy for capacity-building in microfinance, enhancing customer protection and setting up a credit information exchange system.

E. ADB's Sector Support Program and Experience

20. ADB has supported the government's initiative to establish the formal MFI sector with 2 TA grants: TA 3741-VIE[1] provided in 2001 and TA 4638-VIE[2] in 2005, supporting the preparation for the microfinance legal framework. As a result, in March 2005 Decree No. 28/2005/ND-CP (Decree 28) on the Organization and Operation of Microfinance Institutions in Viet Nam was issued, followed by Decree No. 165/2007/ND-CP (Decree 165) issued in November 2007 to supplement Decree 28. In 2009, ADB approved a JFPR grant (JFPR 9140-VIE)[3] to support the implementation of Decrees 28 and 165. The JFPR provides technical assistance and supplementary matching funds to assist the transformation of semi-formal microfinance programs to formal regulated MFIs. Finally, in 2010, ADB TA 7499 was launched to: conduct a sector assessment, assist government in drafting its microfinance strategy and roadmap, and design the Microfinance Development Program. Lessons learned from the past ADB's and other donors' assistance to the sector in Viet Nam and the region include the importance of (i) integration of microfinance regulation in the general banking law which should be harmonized with other microfinance regulations to provide diverse financial institutions with a level playing field in order to promote microfinance in a fair competition, and (ii) the government focusing on the formulation of a enabling environment to support private sector development in microfinance.

F. Other Development Partner Support

21. The most notable donor partners in the microfinance sector of Viet Nam, include the Agence Francaise Developpement that assisted CCF and launched an advisory TA for SBV late 2011; the World Bank mainly through its series of Rural Finance Projects that wholesales for micro-loans to credit institutions and provide TAs to some stakeholders; Spanish Agency for International Development Cooperation; Center for International Development Issues; Desjardin International Development; the OPEC Support Fund; and Bill and Melissa Gates Foundation. Rabobank International Advisory Services BV is also reportedly set to assist in the transformation of the PCFs/CCF system.

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[1] ADB. 2001. *Technical Assistance to the Socialist Republic of Viet Nam for Preparing the Framework for Microfinance Development*. Manila.

[2] ADB. 2005. *Technical Assistance to the Socialist Republic of Viet Nam for Implementing the Regulatory and Supervisory Framework for Microfinance*. Manila.

[3] ADB. 2009. *Grant Assistance for Socialist Republic of Viet Nam: Formalizing Microfinance Institutions* (Financed by the Japan Fund for Poverty Reduction). Manila.

Table 1: Microfinance Sector Roadmap and Results Framework

Country Sector Outcomes		Country Sector Outputs		ADB Sector Operations	
Outcomes Supported by ADB	Indicators with Targets & Baselines	Outputs Supported by ADB	Indicators with Incremental Targets (Baselines Zero)	Constraints to Output Delivery	ADB Interventions to Address Constraints
A policy environment conducive to the sound development and growth of a robust, responsive and sustainable microfinance sector Increase in the number of regulated MFIs operating based on market oriented principles Diversified formal financial institutions engaged in microfinance operating on a level playing field Improve viability, sustainability and outreach of the microfinance sector	Number of regulated MFIs and other credit institutions operating based on market oriented principles and the same set of prudential norms and performance standards, offering quality, affordable and sustainable microfinance service Amount of microfinance loans outstanding by product lines and number of active borrowers Number and volume of microfinance products & services (including micro-insurance) State equity in CCF; growth of *true* and active PCF members Amount of subsidy provided to VBSP Quality of micro-loan portfolio	Preparation of the IRR implementing Decree No. 28 which later became Decree No. 165 Preparation of the Manual of Supervision and Chart of Accounts for MFIs Facilitation of Preparation of the draft IRRs of the new CIL	Implementation of the National Microfinance Development Strategy and Roadmap Issuance of the prudential norms and performance standards for all MFIs Issuance of fiscal and regulatory incentives to promote provision of micro-insurance IRR of the new CIL relating to the microfinance sector issued (e.g., e-banking services, consumer protection, setting up MIFs, PCF, cooperative bank) Amendments to Decree No. 18 studied or issued Increase in the number of dedicated and trained MFI supervisors Training to strengthen the capacity of SBV regulators completed Annual budget provided to support capacity building programs for strengthening of SBV and MOF supervisory and regulatory capacity CCF transformed into a cooperative bank and PCF operating based on universally accepted coop principles VBSP's gradually operating based on market oriented principles and attaining self-sustainability Study Conducted to establish a cost-effective credit information exchange in the MFI sector	Lack of a conducive and enabling policy and regulatory environment to develop the microfinance sector Absence of regulated formal MFIs owned and operated by the private sector	TA VIE 4638 Implementing the Supervisor and Regulatory Framework for Microfinance (completed in 30 September 2008) TA VIE No. 9140 Formalizing Microfinance Institutions Project (2009-) TA VIE N0. 7499 Developing the Microfinance Sector Project (2010-)