SECTOR ASSESSMENT (SUMMARY): FINANCE[1]

Sector Road Map

1. Sector Performance, Problems, and Opportunities

1. Viet Nam's economy grew at an impressive average nearing 8% per annum in 2001–2007, until the global financial crisis slowed this average to slightly below 5% in 2008–2009. The economy has regained strength since, yet the crisis exposed a number of vulnerabilities. Specifically, it has become clear that money and capital markets need to be developed to maintain high economic growth rates with macroeconomic stability. Further, the deepening of financial inclusion is needed, especially through the development of microfinance, to ensure resilience in low-income communities and households.

2. **Fast growing equity markets.** Since 2002, the Ho Chi Minh City Stock Exchange has grown to 231 listed stocks with market capitalization of D113 trillion; 105 securities companies and 46 fund management companies are active in the market. Currently, the Hanoi Stock Exchange has 870 listed securities, consisting of 294 listed stocks, 508 listed bonds, and 68 over-the-counter stocks. The Ha Noi exchange's aggregate market capitalization is now D215 trillion.

3. **Small debt markets.** The total local currency bond market represents only 14.2% of the gross domestic product (GDP) and is well below the overall average in emerging East Asian markets, which is 52.1% of aggregate GDP for 2008. Corporate bonds represent only 0.6% of GDP, well below the average in emerging East Asian markets of 12.5%. Moreover, after the global financial crisis, the maturity profile of government debt in local currency became skewed to the short term, averaging only 3.5 years to maturity. The secondary market is still thin and illiquid, as Viet Nam has not established a system of primary dealers who can make two-way markets.

4. **Intermediation overly reliant on weakened banking sector.** Bank intermediation is insufficient to compensate for the limited size of the nonbanking sector and constrained by insufficient capital, limited operational scale, and high credit risk. In addition to concerns about credit quality, this system elevates liquidity risk, as banks provide virtually all of the long-term credit available to commerce with funding provided by short-term deposits. While the joint stock banking subsector is growing, the banking sector is still dominated by the state-owned banks that provide directed and often subsidized credit to select industries.

5. **Resistance to market principles.** The government, through the State Bank of Viet Nam (SBV), applies a mechanism to manage basic dong-nominated interest rates. Since May 2009, credit institutions supervised by the SBV must set their trading interest rates (rates for deposit taking and lending) at a figure not exceeding 150% of the base interest rate, which is subject to periodic change, as announced by SBV . The tenor to which the base rate is intended to apply is not specified for either secured or unsecured lending. This interest rate ceiling is a key

[1] Based on Omar, H. and Schuster, S. Southeast Asia Regional Department Sector Assessment, Strategy and Road Map. Viet Nam: Financial Sector. Manila. Available on request; and ADB. 2011. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Socialist Republic of Viet Nam for Microfinance Development Program II*. Manila. http://lnadbg4.adb.org/sec0066p.nsf/vwLkupAttachments/WPDD-8V99FQ/$file/null%202%20Sector%20Assessment%20Summary%20Microfinance.pdf

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development constraint, as it has created structural issues for the market, raised concerns over the stability of the finance system, and inhibited capital market development.

6. **Inadequate planning and coordination.** Viet Nam's finance sector has developed along product lines rather than holistically, creating to a patchwork of markets. Laws and regulations are supported and issued by various regulatory bodies without the benefit of coordination or collaboration, and specific capital market infrastructure supports unique functions with only limited cohesion. Systems for issuing Treasury Bills and bonds differ, secondary market trading channels are completely segregated, and these exchange platforms are incompatible. Bond markets employ a platform based on equity exchange, while money markets trade over the counter. Repurchase agreements are subject to multiple layers of supervision. The reporting of bond transactions is executed through an equity-style trading platform that relies on brokers.

7. **Low capacity of participants.** Understanding of economic, financial, and in particular legal principles is low, which has led to widespread and continuing disregard of regulations and standards on the part of commercial companies. This problem has remained largely unchecked as the ability of the State Securities Commission (SSC) to enforce regulations and standards is limited. The SSC suffers from the lack of independence and capacity to oversee a market of such size and scope. Regulatory response times are slow, and professional organizations intended to be self-regulatory are too few and require additional training.

8. **Contractual savings presents an emerging opportunity.** While growth in Viet Nam's financial markets and, in particular, its stock market has been remarkable, the customer base has not diversified or seasoned. As a result, the capital market is sometimes highly volatile. Moreover, institutional demand for longer-term asset classes such as bonds is absent from the contractual savings industry. Key needs in this area are to (i) increase the effectiveness of compulsory insurance products, (ii) help the insurance regulator with focused capacity building, and (iii) adopt international financial reporting standards for all insurance companies. While the commercial insurance market in Viet Nam has grown rapidly in terms of premiums, products, and diversity, the performance of the nonlife insurance sector is still lackluster. International life insurers dominate their market but are inactive in the nonlife market, with a combined market share of less than 10%. Conflicts of interest exist at the commercial end of the market, as on many occasions the insured entities and the insurance companies are both owned or controlled by the government. About 1.2 million people are now regular beneficiaries of Viet Nam Social Insurance, but the Viet Nam Social Security System is in danger of insolvency.

9. **Investor and consumer protection lacking.** The market surveillance and monitoring capability of the SSC needs strengthening. The role of self-regulatory organizations should be expanded and clarified with regard to surveillance and monitoring. The framework for consumer protection also needs to be enhanced in the rapidly expanding insurance and microfinance subsectors. As these subsectors expand into new products, new regulations will need to be developed, risk-based regulatory oversight introduced, and accounting standards and information exchange strengthened.

10. **Microfinance industry state-led.** In response to the need to ease financing constraints on the rural poor and low-income households, the government adopted in 2002 a dual approach that is both market-based and state-driven. Market-based lenders are the Vietnam Bank for Agricultural and Rural Development, the Central People's Credit Fund and People's Credit Fund network comprising financial cooperatives, and, to a limited extent, the semiformal microfinance institutions formed by non-government and mass organizations. State lending is through the

Vietnam Bank for Social Policies (VBSP), which has become the dominant micro-credit provider to poor households and disadvantaged groups.[2]

11. **Inadequate microfinance services.** The government's direct involvement in micro-credit delivery through the VBSP crowds out private sector players and hampers the growth of potentially diverse market-oriented microfinance providers. This limits the choices available to the vast majority of low-income rural households, who have no access to a wide range of sustainable and responsive financial services including credit, savings, money transfers, and insurance.

12. **Growing fiscal burden.** The VBSP's subsidized micro-credit is the marginal direct financial benefit to borrower households (estimated at D34,000 per household per month, or 0.7% of an average monthly household income) relative to micro-loans offered by market-based microfinance providers. This cannot justify the increasingly heavy fiscal burden on the government, which grew at an annual average rate of 32% in 2003–2009 and reached D23,580 billion at the end 2009, or 1.4% of GDP. This is aggravated by population growth, inflation, and a surge in student loans in recent years, all expanding the VBSP's social policy lending. To address these flaws, a government strategy to develop market-oriented microfinance operated by diverse credit institutions has been formulated with ADB assistance.

2. Government's Sector Strategy

13. From 2000 to 2009, the government laid the foundations of capital market development. Measures were implemented to remove conflicts and contradictions in applicable law and to harmonize the legal and regulatory framework with international standards. The government began a program of "equitization" of state-owned enterprises, including state-owned banks, to raise capital and provide listings for the fledgling stock market. The government promulgated a securities and exchange law supported by a series of implementing regulations that strengthened corporate disclosure requirements and the supervisory, investigatory, surveillance, and enforcement mechanisms of the SSC. The SSC is enhancing training and further developing its regulatory resources. To enhance and strengthen the banking sector, the SBV has encouraged the consolidation of private joint stock banks by raising bank's minimum permissible capitalization. Meanwhile, the government strengthened SBV's capacity to resolve the problem of undercapitalized banks through mergers or direct intervention.

14. The government has developed the Sector Road Map for Strategic Development of the Vietnamese Capital Market.[3] By 2015, the government will launch a coordinated effort to develop the short-term money market and deepen the government bond market. The Debt Management Office has been created, and the Ministry of Finance will issue and revise decrees to reform the primary dealer system and liberalize participation in the government debt market, progressively relaxing controls on interest rates. Capacity development will be coordinated among regulators, government agencies, and the private sector through an overarching strategy to structure an internal and sustainable training program. From 2015 to 2017, additional amendments to the legal code will open competition, enhance disclosures, and support financial

[2] As of the end of July 2010, VBSP had lent to 7.8 million household borrowers, of which 3.8 million are reportedly poor or disadvantaged households. It held a 49% share of the microfinance market. The Vietnam Bank for Agricultural and Rural Development held a 39% share of the market, and others, including the people's credit funds, held a 12% share.

[3] The Ministry of Finance and the SSC have completed the road map for the strategic development of the Vietnamese capital market, which covers 2010 to 2020. This is the master plan for long-term capital market development and addressing market infrastructure bottlenecks that impede the growth of the capital market.

literacy. The Viet Nam Securities Depository will be upgraded to become a central counterparty, and the stock markets will be combined under a holding company and prepared for eventual privatization.

15. Recognizing the vital role of microfinance as a potent tool to reduce poverty, the Prime Minister approved the National Microfinance Development Strategy, which aims to (i) establish legal, policy, regulatory, and supervisory frameworks; (ii) strengthen policy, regulatory, and supervisory capacity; (iii) enhance the operational capacity of microfinance institutions; (iv) develop finance infrastructure including a training institute and a credit information bureau; and (v) conduct a national campaign to improve financial literacy. This confirms the government's firm commitment to transforming the sector into a robust financial market supported by vibrant operations based on the market principles.

3. ADB Sector Experience and Assistance Program

16. The Financial Sector Program Loan (Phase 1) supported the introduction and adoption of basic concepts and systems integral to a market-based finance system and economy. Phase 2 supported the development of a more diversified, competitive, and resilient finance sector. Phase 3 systematically built capacity for finance sector development. ADB's most recent country assistance program evaluation recommended continuing financial and technical support for finance sector reform.[4]

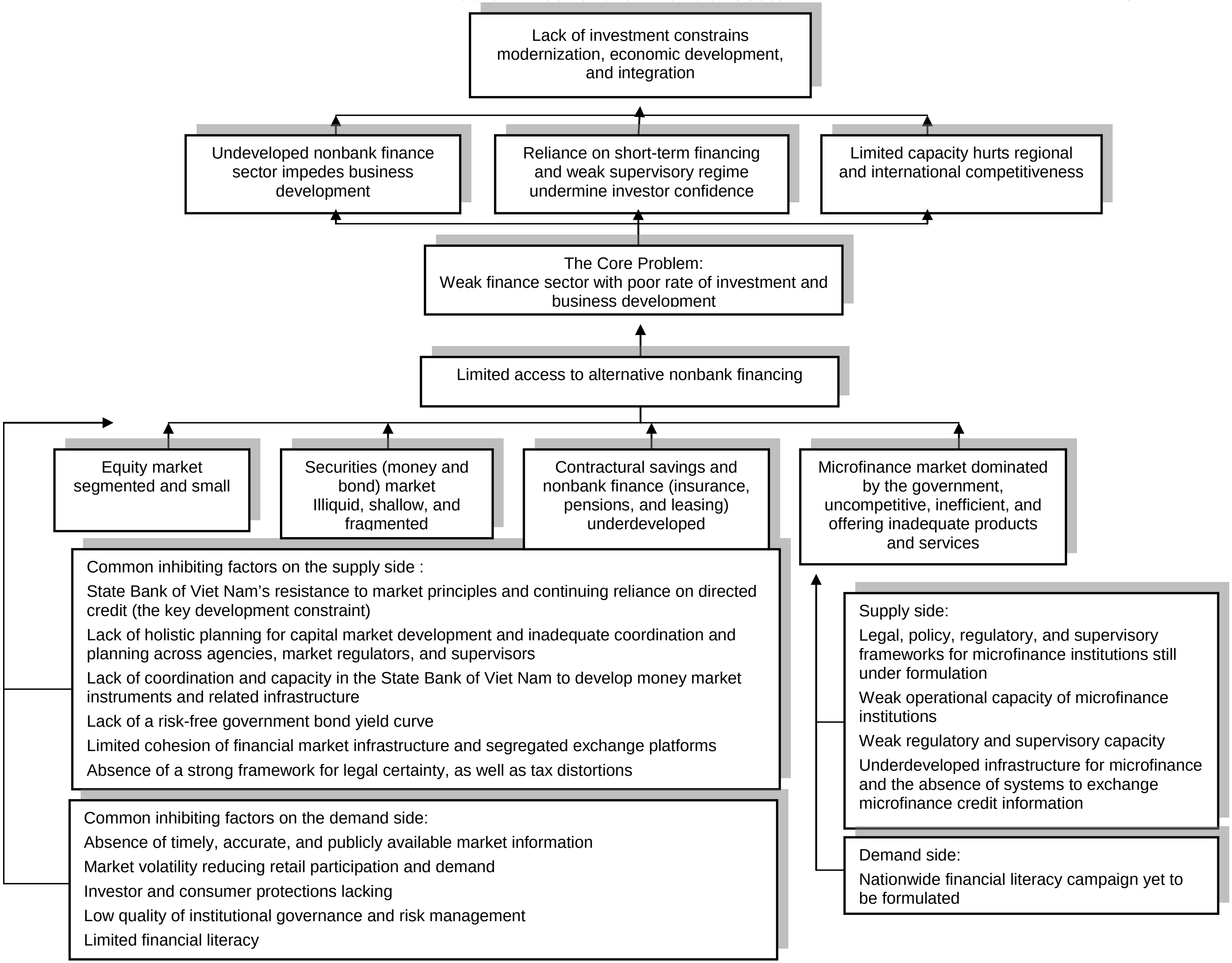
17. Given the expanded scope of the finance sector and its importance, ADB will narrow its focus to achieve tangible results. Policy-based assistance will improve the efficiency of the money market and deepen the capital market for enhanced financial intermediation. Developing the money market will allow the government to better manage inflation through monetary intervention, while a deeper bond market will enable the channeling of long-term funding to much-needed infrastructure projects.

18. Regarding microfinance, the proposed microfinance development program will support the government's policy reform agenda to improve the quality, accessibility, efficiency, and competitiveness of microfinance in line with the government development strategies. The program aims to

- (i) create a policy and regulatory environment conducive to the development of an inclusive and sustainable market-oriented microfinance sector,
- (ii) strengthen the supervisory and regulatory capacities of microfinance regulators,
- (iii) strengthen financial institutions involved in microfinance to provide affordable and sustainable services to the poor, and
- (iv) develop financial infrastructure for microfinance.

[4] ADB. 2009. *Viet Nam: Country Assistance Program Evaluation.* Manila.

Problem Tree for the Financial Sector



Sector Results Framework (Finance, 2012–2015)

Country Sector Outcomes		**Country Sector Outputs**		**ADB Sector Operations**	
Sector Outcome with ADB Contribution	**Indicators with Targets and Baselines**	**Sector Outputs with ADB Contribution**	**Indicators with Incremental Targets**	**Planned and Ongoing ADB Interventions**	**Main Outputs Expected from ADB Interventions**
Nonbank finance markets provide an increased share of financing to support domestic investment .	Share of nonbank finance sector assets to total financial sector assets increasing from 15% in 2010 to 25%–30% in 2015 Increase in the size of the local currency debt market to 20% of GDP in 2015 from 15% in 2010 Increase in combined stock market capitalization to 45% of GDP in 2015 from 38% in 2010	Alternative channels of market-based nonbank financial intermediation developed	Iecrease in short-term debt papers of various maturities of less than 1 year Increase in the proportion of government bonds with maturity of 3–5 years to more than 25% of the total government bonds outstanding by 2014 Decline in the bid–ask spread of government bonds to below 10% starting in 2014 from 13% in 2010 At least 15% decline in the number of government issuances by 2014 Increase in the number of staff trained by about 15% from 2010 to 2015	**(i) Planned key activity areas** Capital market development Microfinance **(ii) Pipeline projects** FSDP (2012, $50 million; 2014, $75 million) Microfinance Development Program loan: Subprogram 1 of ADF $40 million Subprogram 2 of ADF $50 million (indicative) Supporting Microfinance Development Program (ADB PATA of $0.5 million) Strengthening Microfinance Operation and Regulation (ADB CDTA, $1 million)	**(i) Planned key activity areas** Enhanced capital market size and liquidity, increased insurance coverage and old-age protection, strengthened institutional framework and market infrastructure, enhanced legal and regulatory framework, and better staff capacity **(ii) Pipeline projects** A well-functioning money market, deeper and more liquid financial market, and improved institutional capacity Microfinance Development Strategy and road map approved, increased number of licensed microfinance institutions and cooperative banks, reporting microfinance client data disaggregated by sex in place Strengthened supervisory and regulatory capacity in the microfinance regulators Strengthened credit institutions involved in microfinance to provide affordable and sustainable services to the poor
Increased access for poor and low-income households to sustainable and affordable microfinance services	Number of microfinance borrowers increasing by 10% in 2014, (2010 baseline: 12.5 million) Number of savings accounts increasing by 10% in 2014 (2010 baseline: 9.7 million)	Microfinance services expanded	Increase in the number of licensed microfinance institutions from 2 in 2012 to 5 in 2014 Increase in the number of trained regulators by 30% from 2012 to 2014 Improvement of operational self-sufficiency in the VBSP to 90% in 2014 from 77% in 2010 A microfinance center established by 2014	Preparing Microfinance Development Program Subprogram 2 (ADB PPTA, $0.6 million)[c] **(iii) Ongoing projects** Preparing Microfinance Sector Development Program (ADB PPTA, $0.5 million) Formalizing Microfinance Institutions (ADB JFPR, $1.5 million) TFSP (PPTA, $1 million) FSDP (PPTA, $0.6 million)	Infrastructure that supports microfinance through a microfinance center at the Banking Academy; developing a microfinance-specific credit information exchange system at CIC **(iii) Ongoing projects** Inputs to the formulation of the programmatic approach and subprogram 1 of the Microfinance Development Program Formalized microfinance institutions Enabled environment, strengthened supervision, and improved standards Money market established, a more liquid bond market, and capacity developed

ADB = Asian Development Bank, ADF = Asian Development Fund, CIC = Credit Information Center, CDTA = capacity development technical assistance, FSDP = Financial Sector Deepening Program, GDP = gross domestic product, JFPR = Japan Fund For Poverty Reduction, PATA = policy and advisory technical assistance, PPTA = project preparatory technical assistance, TFSP = Trade Facilitation Support Project, VPSP = Vietnam Bank for Social Policies.
Source: Asian Development Bank.