

## MICROFINANCE IN VIETNAM – POLICY ASSESSMENT

### 1. INTRODUCTION

The present assessment has been developed with the support of CGAP<sup>1</sup> who, at AFD's request, accompanied an AFD mission in June 2008 and participated in discussions with the SBV about a possible program in Vietnam.

### 2. MICROFINANCE IN VIETNAM<sup>2</sup>

The microfinance sector in Vietnam has emerged during a period of robust economic growth since 2000. Demand for financial services has increased with rising incomes and dropping poverty levels. Vietnam has lowered its poverty headcount from 58% of the population in 1993 to 24% in 2007. The economically active population of around 64 million people represents a growing demand for microfinance services. During this impressive growth period, the Government of Vietnam (GOV) has dominated the supply of financial services to lower income segments through an array of state-owned banks and poverty alleviation programs that reach an estimated 80% of the population. In relative terms and by international standards, non-governmental initiatives are incipient and small.

The Vietnam Bank for Agriculture and Rural Development (VBARD) is the country's largest commercial bank and has the broadest reach into the rural areas. At the end of 2007, VBARD had a loan portfolio of \$14 billion. Although VBARD services some of the largest state-owned enterprises and almost 30,000 small and medium enterprises (SMEs), VBARD also reaches 10 million farming households in lower income segments. VBARD has an extensive branch network and will likely continue to be a very significant provider of financial services to lower income segments, particularly in rural areas.

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<sup>1</sup> Mark Flaming (CGAP Consultant) and Klaus Prochaska (CGAP) participated in this mission and drafted this document with inputs from Marie Laure Garnier & Philippe Serres (AFD), and Eric Duflos (CGAP). Established in 1995 and housed at the World Bank, CGAP is an independent policy and research center dedicated to advancing financial access for the world's poor. It is supported by over 30 development agencies and private foundations who share a common mission to alleviate poverty. CGAP provides market intelligence, promotes standards, develops innovative solutions and offers advisory services to governments, microfinance providers, donors, and investors.

<sup>2</sup> This section summarizes issues that are developed in detail in the February 2007 DFC/World Bank report, *Vietnam: Developing a Comprehensive Strategy to Expand Access [for the Poor] to Microfinance Services*, as well as other recent sector studies.

The Vietnam Bank for Social Policy (VBSP) was separated from VBARD in 2002 and has developed a vast infrastructure for distributing subsidized credit to low income populations. Through about 600 district-level branch offices and transaction points in 8700 of Vietnam's some 10,000 communes, VBSP maintains a current portfolio of \$2.1 billion, reaching 5.6 million clients. VBSP manages at least 7 targeted lending programs, charging interest rates that range from a quarter to half of prevailing commercial rates. The VBSP subsidies cost the GOV \$87 million in annual budget resources (2007). VBSP is not subject to banking regulation by the SBV, but is directly controlled by the GOV under specific regulations.

The Postal Savings Bank (PSB) provides savings services through 844 postal offices to middle and lower income customers. In June of 2008, the PSB had about \$400 million in savings. The PSB is not authorized to lend, however, and transfers resources to other state banks for that purpose. PSB management reports that they have received instruction to convert to a joint-stock bank, a move that could provide the PSB with both resources and mandate to reach large numbers of the population.

The People's Credit Funds (PCFs) were introduced in the early 1990s to replace a failed credit cooperative system with a mutual savings and loan institution modeled on the Canadian *Caisse Populaire*. There are currently some 1000 PCFs in 56 provinces with a membership of 1.3 million households. The combined portfolio of the PCFs at the end of 2007 was \$1 billion, about 65% of which is funded by member and public savings. Apart from VBARD, the PCFs are the only financial intermediaries that are regulated and supervised by the State Bank of Vietnam (SBV) and that are currently positioned to offer a broad range of financial services to lower income segments.

The "semi-formal" sector consists of about 50 small organizations that self-report a combined portfolio of \$60 – 70 million and about 500,000 clients. The two largest microfinance organizations (MFOs)<sup>3</sup>, CEP and TYM, had portfolios of only \$13 million and \$4.4 million respectively at the end of 2007; none of the remaining MFO portfolios surpass \$500,000.

### **3. ROLE OF GOVERNMENT IN MICROFINANCE**

The foregoing summary demonstrates that Vietnam has a variety of institutions that provide financial services to low-income populations. However, policy discussions around access to finance, as well as the initiatives themselves, have been driven largely by a more narrow interest in targeting specific income sectors with "microcredit" (with the notable exception of the PCFs). This has had two important implications for the development of a microfinance industry:

- First, the focus on credit by both GOV and non-governmental programs has preempted a more comprehensive strategy for delivering a range of financial services that is appropriate to the different income segments. The benefits of credit to the poor have been exaggerated to

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<sup>3</sup> In Vietnam, the term "microfinance organization" is used synonymously with "semi-formal" organizations to refer to a variety of non-profit organizations that provide mostly credit services to lower income populations. The term distinguishes these organizations from "microfinance institutions," which will be licensed to engage in a broader range of financial activities by the SBV.

the same degree that the importance of other services like savings, payment services and insurance has been underestimated.

- Secondly, the GOV has used subsidized microcredit as a poverty-alleviation instrument on a scale that has inhibited the development of commercially viable financial intermediaries in the sector.
- And thirdly, almost all of the MFOs have been launched as credit components in larger community development organizations, and are currently housed in institutional structures that have limited autonomy for future development and growth.

Recent GOV policy initiatives reflect an emerging interest in creating space for the development of a commercially viable microfinance sector. Policy signals reflect conflicting views on this, however. The draft *Decree Regarding Credit for the Poor and Beneficiaries of Social Welfare* (2007/ND/CP) reiterated GOV commitment to channeling subsidized credit to the poor.<sup>4</sup> At the same time the VBSP is currently engaged in a strategic planning exercise, mandated by the Prime Minister, with a long term goal of moving towards financial sustainability and charging closer to commercial rates.

The GOV has also issued Decrees 28 and 165, which enable existing MFOs to join a limited liability company that is eligible for a special license to engage in financial intermediation under the regulation and supervision of the SBV. The regime has been criticized by the MFO community who feel that the eligibility requirements for an MFI license are unrealistic. The regime will undoubtedly benefit from marginal adaptations in future Decrees or SBV Circulars. However, the main challenges to the MFO sector, and the principal reasons they cannot qualify for the core eligibility requirements, are related to their current legal status as semi-formal organizations, specifically their lack of legal independence from the mass organizations.<sup>5</sup>

The mass organizations occupy a central position in the delivery of financial services to underserved populations. For example, the Vietnam Women's Union (VWU) owns and operates the second and third largest MFOs, manages around 40 savings and credit schemes with international NGO partners, and plays a significant operational role in channeling credit services for the VBARD and VBSP. With few if any exceptions, the mass organizations play a dominant or significant role in the governance of all existing MFOs.

In practice, it is extremely difficult in Vietnam to establish a legally independent non-profit organization or for-profit limited liability company that can receive support and contract services with international development partners and provide credit services. The difficulties result from highly segmented laws and regulations governing legal incorporation and the activities of different organizations. As a result, aspiring microfinance providers in Vietnam cannot use the

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<sup>4</sup> CGAP coordinated comments on the draft decree from six international aid agencies. The comments, submitted by the ADB to the Government in May 2008, included a detailed rationale for creating commercially viable models for financial intermediation and for developing policy instruments other than credit for assisting those below the poverty line.

<sup>5</sup> The mass organizations are an integral part of Vietnam's political party structure. They are nation-wide networks that partner with GOV agencies and international NGOs to deliver a broad range of community development services.

basic legal vehicle that has been employed in most developing microfinance markets to launch non-profit initiatives, partner with international resource organizations, and eventually graduate to a sustainable financial institution. Vietnamese microfinance organizations have created complex relationships with mass organizations and even incorporated under various legal forms in their attempt to establish a corporate legal identity with rights to offer basic credit services. They are, with few exceptions, credit components of integrated community development organizations -- a model that has failed in most countries to produce sustainable microfinance institutions. While the largest programs have clearly developed specialized technical capacity, they have not yet established legal and in many cases operational and financial independence from their founding mass organization.

Decrees 28 and 165 position the SBV to regulate and supervise the MFOs that are able to transform into licensed MFIs. The SBV will play a central role as well in the ongoing development of policies that will drive the development of microfinance services and, ultimately, access to finance. The following areas of action will be key components of a strategy for developing a microfinance industry that is integrated into the broader financial markets:

- **Regulation of commercial banks and PCFs**

As the regulator of the formal financial system, the SBV is well positioned to create an enabling regulatory environment that is conducive to the provision of microfinance services. Given their scale and physical infrastructure, the state banks are likely to play a very significant role in the provision of services for all economic sectors. Joint stock banks may also eventually be motivated to move down market. Vietnam may also be an attractive market for a de novo initiative by one of the international or regional microfinance bank networks. And finally, the PCFs are already established as the most viable institutional form of specialized financial intermediary. The body of laws, regulations and supervisory practices that govern these segments of the financial industry can be improved to facilitate the development of microfinance services and specialized institutions.<sup>6</sup> Commercial banks and PCFs will be by far the largest provider of financial services to lower income segments for years to come and SBV regulation of this sector will have the most significant impact on access to finance.

- **Policy dialogue regarding GOV credit policy and the VBSP**

The SBV will also be influential in shaping GOV policy regarding credit for the poor in general and the VBSP in particular. To play that role effectively, the SBV needs to be able to articulate a clear strategy for developing a commercially viable financial market that reaches down market. SBV can also contribute to the broader policy issue of poverty alleviation with a clear presentation of the costs and benefits associated with the current use of subsidized credit.

- **Development of specialized regulatory and supervisory capacity**

The SBV aspires to develop specialized capacity related to the regulation and supervision of microfinance institutions and services. Regulatory and supervisory functions are currently oriented towards more conventional commercial banking and are very fragmented among

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<sup>6</sup> CGAP's policy diagnostic framework provides a systematic approach to identifying modifications to laws, regulations, and supervisory practices.

different operational and regional departments. It is worth mentioning here however that through the recent Decree 96/200/ND –CP, a Financial Supervision Agency was created at SBV, merging four departments (Bank and Non Bank, Banking Supervision, Credit Cooperatives and AML Center). The Decision 83/2009/QD-TT prescribed the functions of the FSA. This agency is still at its initial stage but its creation reflects a move towards streamlining the supervision functions of SBV.

#### 4. RECOMMENDATIONS FOR DONOR SUPPORT IN VIETNAM

Based on the above assessment, several areas of possible support have been identified for donors willing to support the expansion of access to finance in Vietnam.

**4.1). Further analyze the market:** Donors could conduct research in cooperation with SBV to complement existing studies of the microfinance sector<sup>7</sup> by focusing specifically on the legal, regulatory and organizational factors that drive the performance and growth potential of the service providers and competitive forces in the market.

- **Conduct assessment of the supply of pro-poor financial services.**  
The assessment should include an appraisal of the performance and capacity of different service providers, including the VBSP, VBARD, MFIs to be established according to Decree 28/2005/NĐ-CP dated 9/3/2005 and Decree 165/NĐ-CP on 15/11/2007), the Postal Savings Bank, the People’s Credit Fund network, microfinance projects of semi-formal Vietnamese and foreign non-governmental organizations.
- **Conduct assessment of legal and regulatory framework that governs the organization and scope of activities of all potential microfinance service providers.**  
This assessment would complement the supply study with a focus on the organizational structure of the industry. The study should examine whether the legal and regulatory framework facilitates the creation and growth of the different types of service providers, and whether the mix of different types of provider organizations is conducive to the development of a competitive microfinance industry. The scope of this study could also include a review of regulation related to “branchless banking”. Branchless banking is defined as the delivery of financial services outside conventional bank branches, often using agents and relying on information and communications technologies to transmit transaction details – typically card-reading point-of-sale (POS) terminals or mobile phones.
- **Conduct a cost-benefit appraisal of current programs using subsidized credit as a policy instrument for poverty alleviation and make recommendations for the future direction of these programs.**  
This initiative is meant to support the SBV in its policy dialogue with the GOV around alternatives to the subsidized credit programs. The SBV believes that a

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<sup>7</sup> For example, the previously cited 2007 WB/DFC report.

rigorous examination of VBSP practices will strengthen support for more commercial alternatives.

- **Conduct a feasibility study for a wholesale financing facility for funding microfinance institutions.**

This study addresses VBSP's own plans to transform into a wholesale lending facility. Ideally, this study would be based largely on the results of the first study of microfinance service providers, which will indicate whether there is enough demand for refinancing from qualified institutions. This study should also explore whether this demand can be met by existing commercial actors such as private banks and/or deposits.

**4.2) Support the definition of a legal and regulatory framework** that enables a range of financial institutions to provide financial services to currently underserved populations. The initiative would be based on the above studies. The studies shall inform recommendations and, ultimately, future decisions about the legal organization of the different service providers, the regulations and supervision that govern their conduct and the aspects of government credit programs that influence competition in the market.

The following strategic priorities reflect the key issues to be addressed:

- The legal and regulatory framework should maximize the ability of all existing service providers to compete in the microfinance market.
- The different service providers should be encouraged to compete against each other in ways that result in better services and the best possible prices for the clients.
- Service providers that currently provide subsidized credit require alternatives that foster more financially sustainable activities and that eliminate current price distortions in the market.
- All service providers need to be able to attract commercial funding in conditions conducive to competitive growth.
- The legal and regulatory framework that governs the legal organization of service providers needs to create institutional independence and incentives for good performance.

**4.3) Assist SBV to centralize its activities related to regulation and supervision of microfinance service providers.** . The recent creation of a specialized unit within the SBV suggested at the outset of the mission will reduce the fragmentation of regulatory and supervisory functions between departments and regional offices of the SBV. This unit could guide the evolution of the regulatory regime as the microfinance industry develops if it is staffed appropriately.

**4.4) Develop specialized capacity of SBV around a regulatory and supervisory model appropriate for Vietnam.** This capacity building exercises could take place with deliberate choices about how the SBV will regulate and supervise the different service providers in the microfinance industry. The SBV could examine the regulatory and supervisory regimes of other countries with well developed microfinance industries to inform this choice. Possible activities could consist in:

- **Researching applicable regulatory and supervisory models from other countries.** Donors can assist the SBV in reviewing models from countries with developed microfinance industries and then organizing study tours.
- **Developing a comprehensive SBV workplan for development of regulatory and supervisory model.** With donor support, the SBV could develop a detailed plan for development of the regulations, management systems, and operational capacity required to implement their chosen model.
- **Developing regulations, supervisory procedures and reporting formats.** A big part of the work in creating the regulatory regime will be in developing regulations and supervisory instruments. Technical assistance could be provided by donors in this area too.
- **Training the Microfinance Unit of the Financial Supervision Agency.** Donors could provide funding for training a microfinance unit. The role of this unit will evolve as the SBV makes decisions about the regulatory and supervisory framework for the microfinance industry.

**4.5) Support the operational capacity of the Microfinance Working Group.** Given its current role and potential to be an important resource for the industry, donors may provide assistance in a coordinated way to the MFWG. Key priorities are the following:

- **Strengthen the capacity of the MFWG in terms of sustainability and legal status.** Currently the MFWG is an informal organization, poorly staffed, highly dependent on grants from donors, that only represents some semi-formal MFOs (the smallest part of the Vietnamese microfinance portfolio). Any support to this organization should envisage its legal registration, strengthening its capacity to represent a broader segment of the microfinance industry, and the development of valuable services to its members that could enable its financial self-sufficiency.
- **Develop the capacity of MFWG to support the transition of semi-formal organizations to licensed MFIs.** The MFWG is meant to publish performance data on the emerging microfinance organizations. The practice of generating performance indicators and submitting regular and standardized reports will create transparency in the industry, an information source for the SBV, and prepare the organizations for the more rigorous reporting requirements they will encounter when they are regulated.

**4.6) Ensure strong donor coordination.** Donors that support access to finance in Vietnam need to enlist the support of other key development agencies in Vietnam like the World Bank and the Asian Development Bank in their effort. If the key development agencies commit to engaging the SBV and other GOV ministries in a dialogue around a common roadmap for building a sustainable microfinance industry, every donor project will better support the industry as a whole. CGAP has developed tools to enable funders to better coordinate their support based on their respective comparative advantages. <http://www.cgap.org/p/site/c/template.rc/1.26.2110/>

## **5. *AGENCE FRANCAISE DE DEVELOPPEMENT (AFD) INVOLVEMENT***

Based on the recommendations of this assessment and on a strong interest of the SBV, AFD has decided to implement a support program to SBV that would encompass some of the activities suggested by CGAP. Negotiations about the program are on track and should lead to the actual launching of the program in 2010.