REIMAGINING VIET NAM'S MICROFINANCE SECTOR

RECOMMENDATIONS FOR INSTITUTIONAL AND LEGAL REFORMS

Ron Bevacqua, Duong (Sophie) Nguyen, and Don Lambert

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Reimagining Viet Nam’s Microfinance Sector Recommendations for Institutional and Legal Reforms

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ABBREVIATIONS

ADB	–	Asian Development Bank
ATM	–	automated teller machine
BRAC	–	Bangladesh Rehabilitation Assistance Committee
CCG	–	Central Guarantee Agency
CEP	–	Capital Aid for the Employment of the Poor Microfinance Institution
CGAP	–	Consultative Group to Assist the Poor
CIL	–	Credit Institutions Law
Co-Op	–	Cooperation Bank
CSF	–	Credit Support Fund
DFID	–	Department for International Development of the United Kingdom
IFAD	–	International Fund for Agricultural Development
IFC	–	International Finance Corporation
LVPB	–	LienVietPostBank
MIFA	–	Microfinance Initiative for Asia
MIV	–	microfinance investment vehicle
MFI	–	microfinance institution
MFO	–	microfinance organization
MFP	–	microfinance program
MSP	–	microfinance service provider
NFIS	–	National Financial Inclusion Strategy
NGO	–	nongovernment organization
PAR	–	portfolio at risk
PCF	–	people's credit fund
PMIC	–	Pakistan Microfinance Investment Company
PKSF	–	Palli Karma-Sahayak Foundation
PPAF	–	Pakistan Poverty Alleviation Fund
PSL	–	priority sector lending
RBI	–	Reserve Bank of India
SBP	–	State Bank of Pakistan
SBV	–	State Bank of Vietnam
SIDBI	–	Small Industries Development Bank
SFMC	–	SIDBI Foundation for Microcredit
SMEs	–	small and medium-sized enterprises
TYM MFI	–	Tao Yêu Mày Tinh Thuong One-Member Limited Liability Microfinance Institution Microfinance Institution
VBSP	–	Vietnam Bank for Social Policies
VWU	–	Viet Nam Women's Union

ABSTRACT

It has been 16 years since the Government of Viet Nam issued Decree 28/2005/ND–CP[1] on the organization and operations of microfinance institutions in Viet Nam that established the legal foundation for the microfinance sector in the country, and almost 10 years since the government promulgated Decision 2195/QD–TTg [2] *on Approving the Proposal of Designing and Development of Microfinance System in Viet Nam up to 2020* that set the sector's development strategy.

Despite this support, Viet Nam's microfinance sector continues to underperform its peers in Asia and elsewhere. Most microfinance service providers[3] (MSPs) are growing slowly, if at all.

This paper traces the causes of this underperformance to two factors. The first is limited access to funds and the second is a general lack of a commercial mindset among MSPs. The sector lacks access to funds for a number of reasons. For example, MSPs lack sufficient collateral to qualify for a loan from Vietnamese banks. In addition, regulations effectively limit microfinance projects and programs from borrowing in foreign currency[4] and the amount of deposits they can mobilize.[5]

However, this paper's key finding is that limited access to funds is the consequence of a more fundamental challenge, which is the lack of a commercial mindset among MSPs. This problem is the result of policy choices. It is not merely an issue of regulatory gaps or underdeveloped market infrastructure. Existing laws and regulations conceptualize microfinance as a social activity delivered by nongovernment organization (NGOs). NGOs were the main providers of microfinance around the world in the 1990s, and Viet Nam's microfinance sector began the same way. However, while the global industry shifted to a more commercial model that is both more able to access wholesale loans to fuel growth and more capable of managing that growth, Vietnamese MSPs remain rooted in their early history. Current regulations prevent Vietnamese MSPs from making the transition to a more commercial model.

In other words, the sector's lack of funds for onlending is more a symptom than a cause of underperformance. Funders require professional management, growth potential, and transparency, all of which are insufficient in Viet Nam's microfinance sector. Even if more wholesale funds had been available since Decision 2195 was issued, growth may not have been much faster because the sector as it is currently constituted is not capable of strong growth.

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1 Decree No. 28/2005/ND–CP on *the organization and operations of microfinance institutions in Viet Nam*, 9 March 2005.

2 Decision No.2195/QD–TTg on *approving the Proposal of Designing and Development of Microfinance System in Viet Nam up to 2020*, 6 December 2011.

3 In this paper, "microfinance service providers (MSPs)" refers to nongovernment microfinance institutions (MFIs), microfinance organizations (MFOs), and microfinance programs (MFPs) providing microloans and deposits. Although the Government of Viet Nam considers the Vietnam Bank for Social Policies to be a microfinance service provider, it will be treated separately as a state-owned bank and is not included in the definition of MSP in this paper.

4 Circular 34/2019/TT–NHNN, on *Guidance on Foreign Exchange Management Regarding Foreign Currency Funding of Microfinance Programs and Projects of Political Organizations, Socio-Political Organizations and Non-Governmental Organizations*, Article 3, 6 December 2011.

5 Decision 20/2017/QD–TTg on *the Operations of Microfinance Programs and Projects Run by Political Organizations, Socio-Political Organizations, and Non-Governmental Organizations stipulates that the total voluntary saving deposits shall not exceed 30% of total capital provided to that microfinance program*, Article 13(1)(b), 12 June 2017.

With the promulgation of the National Financial Inclusion Strategy,[6] the Government of Viet Nam recognizes the important role that microfinance can play in financial inclusion. The potential revision of the Credit Institutions Law and regulations for microfinance provide an opportunity to promote a new vision for the sector. Although the NGO-oriented microfinance institutions and microfinance programs and projects run by the Viet Nam Women's Union and other sociopolitical organizations still have an important role to play, over-relying on them to contribute to the goals of the National Financial Inclusion Strategy will lead to continuing underperformance. All the other major microfinance markets supplement NGO-oriented MSPs by allowing other providers to take a more commercial approach, and Viet Nam should consider the same to increase the supply of financial services to the kinds of low-income, low-collateral, and small-transaction households who make up the bulk of Viet Nam's financially excluded.

As such, this paper's main recommendation is that the Government of Viet Nam should promote a variety of MSP institutional types through holistic regulatory reforms that enable commercially oriented MSPs to be established and grow alongside existing providers. These include (i) encouraging new investment in microfinance institutions by removing restrictions on ownership, (ii) encouraging the formalization and professionalization of microfinance organizations (MFOs) and microfinance programs (MFPs) by creating a new regulatory category of licensed credit-only microfinance institutions, and (iii) removing restrictions on client acquisition that slow growth and discourage investors.

Professionalization, including the entrance of new players, will attract funding from international microfinance investment vehicles as well as some Vietnamese banks. However, as in all markets, this type of funding is neither available nor appropriate for all MSPs. A mechanism is needed to finance MFOs and MFPs that are not yet ready to access fully commercial funding. To fill this gap, this paper's second recommendation is to support the state-owned Co-Op Bank to provide wholesale funds to MFOs and MFPs. Co-Op Bank has the relevant experience, interest in entering the market, and available liquidity. The demonstration effect from a domestic institution like Co-Op Bank lending to MSPs will help encourage other banks to enter the market.

[6] Decision 149/QD–TTg on *the Approval of the National Financial Inclusion Strategy to 2025 and Vision toward 2030*, 22 January 2020.

I. OVERVIEW AND ANALYSIS OF THE MAIN CONSTRAINTS ON THE SECTOR'S DEVELOPMENT

A. Taxonomy of Microfinance Service Providers

1. According to the Consultative Group to Assist the Poor (CGAP), the World Bank's lead organization for promoting microfinance and financial inclusion, "Microfinance means building financial systems that serve the poor."[1] Generally, microfinance can be defined as financial services delivered to people otherwise excluded from the mainstream financial system, either because of their low level of income, lack of education, distance from mainstream providers, or other disadvantages.

2. Vietnamese regulations[2] for microfinance are generally aligned with CGAP's definition: "A microfinance client means an individual who is a member or representative of a poor household, near-poor household, household escaping poverty, household having average living standards, an individual having low income, [or a] microenterprise."

3. The key point is that microfinance is defined by the characteristics of the clients, not the design of the financial products, how they are delivered, or the legal type of institution providing microfinance services. For example, although microfinance loans are often small and uncollateralized, so are consumer loans to middle-class households, but the latter is not considered microfinance. That said, Vietnamese regulations define a microfinance loan by certain design characteristics: it is secured by compulsory savings and/or a guarantee by a group of microfinance clients, and must not exceed D50 million ($2,150).[3]

4. Using a definition of microfinance based on the characteristics of clients, it can be said that Viet Nam has a complex microfinance system, with different types of institutions targeting slightly different market niches, albeit with considerable overlap.

1. Government-Supported Systems

5. To date, Viet Nam has mainly relied on state-owned banks and other government-supported banks to deliver microfinance services and promote financial inclusion. The main provider of financial services to poor households is the Viet Nam Bank for Social Policies (VBSP), originally established in 1995 as the "Bank for the Poor" under Agribank and transformed into a separate "policy bank" in 2002, mainly to serve households identified as poor or disadvantaged by local People's Committees based on parameters set by the Ministry of Labor, Invalids, and Social Affairs. Its lending operations have evolved considerably since then.[4] VBSP's 2019 annual report shows that it has more than 20 programs, including those that serve "near poor" households, households graduating from poverty, disadvantaged students, workers who are ethnic minorities in disadvantaged areas, migrant workers, targeted businesses in remote areas, and qualified small and medium-sized enterprises (SMEs). The bank also recently began

1 Consultative Group to Assist the Poor. 2004. *Key Principles in Microfinance*.
2 Decision No. 20/2017/QD–TTg, Article 3.2 on *Regulations on Activities of Microfinance Programs and Projects of Political Organizations, Socio-Political Organizations and Non-Governmental Organizations*; Circular No. 03/2018/TT–NHNN, Article 3 on *Licensing, Organization and Operation of Microfinance Institutions* uses slightly different definition of microfinance clients, which does not include households having average living standards and individuals having low income.
3 Decision No. 20/2017/QD–TTg, Article 13(2) (b.ii and c) and Circular No. 03/2018/TT–NHNN, Article 32(3) and (5).
4 Decision No. 62/2004/QD–TTg on *lending for implementing national strategy on clean water and rural sanitation*; Decision No. 212/2006/QD–TTg on *lending to business, production and service units, enterprises using post-detoxification employees*; Decision No. 157/2007/QD–TTg on *student loans*.

offering consumer credit in addition to its regular loans to protect low-income customers from the high rates charged by commercial consumer lenders.

6. VBSP's lending operations focus mainly on the poor and are not limited by geography or economic sector, but two other government-supported banks specialize in serving farmers and other rural economic actors. The first is the Viet Nam Bank for Agriculture and Rural Development (known as AgriBank), a state-owned commercial bank established in 1988. About 70% of its portfolio is lent for agriculture or in rural areas, and as of 2020 its portfolio accounted for almost 50% of agricultural and rural credit in Viet Nam.[5] As a commercial bank, it also serves other economic sectors, and loans for agriculture, forestry, and fisheries accounted for only 27% of its total loan portfolio as of the end of June 2020.[6] Just over half of its client base is low income, and 22% of its portfolio is lent to them through solidarity methods that are a common microfinance delivery modality. Agribank delivers its services through a nationwide network of 164 branches, more than 2,000 transaction offices, and more than 3,000 automated teller machines (ATMs), the largest ATM network in the country. It has more than 12 million active card users.[7]

7. Another government-supported institution promoting rural financial inclusion is Co-Op Bank. As of 2019, it had a total loan portfolio of D24.5 trillion ($1 billion), of which 72% (D17.7 trillion or $770 million) is lent to 110,102 individual and enterprise customers. As the apex of the People's Credit Fund (PCF) cooperative system, the remaining D6.9 trillion ($300 million) of its portfolio is lent to PCFs.[8] There are 1,164 PCFs with about 2 million members, about half of whom are farmers. The members are considered to be less poor than VBSP's clients but not as well off as AgriBank's regular (nonsolidarity) borrowers. The PCFs collectively had total loans of D97.6 trillion ($4.2 billion) financed by D103.8 trillion ($4.4 billion) in deposits as of the end of 2019[9].

8. Finally, another major bank providing microfinance services is LienVietPostBank (LVPB). It is a joint stock commercial bank formed in 2011 when Viet Nam Post Corporation signed a 50-year cooperation agreement with LienVietBank to provide banking services through Viet Nam Post Corporation's transaction points. The government owns 18% of its shares. As of June 2018, LVPB had 327 branches in addition to 975 postal transaction offices, enabling it to cover every district in Viet Nam. LVPB provides microfinance services according to the regulatory definition. At the end of 2019, LVPB had a total microfinance portfolio of D2.9 trillion ($124 million) outstanding to 116,000 borrowers, for an average loan size of D25 million ($1,066). However, LVPB cannot be considered a specialist microfinance institution: its microloan portfolio accounts for just 2% of the bank's total loans, and its microfinance deposits are less than 1% of its total deposits.[10]

2. Microfinance Systems

9. In addition to the government-supported systems, there are a large number of nongovernment microfinance institutions (MFIs), microfinance organizations (MFOs), and microfinance programs (MFPs)

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[5] Nhat Minh, 2020. *Agribank, Achievements from Agriculture in Viet Nam in 2020*, and Agribank. 2020. *Annual Report 2019*. According to Agribank's 2019 annual report, p.32: "loans to the economy reached over D1.12 million billion". Outstanding loans in agriculture and rural areas always account for nearly 70% of the total outstanding loans. Agribank's lending funds account for a large proportion of the total outstanding loans of nearly D2 million billion in agriculture and rural areas in Viet Nam today.

[6] Agribank. 2020. *Financial Report 2020*.

[7] Agribank. 2020. *Annual Report 2019*.

[8] Co-Op Bank. 2020. *Annual Report 2019*.

[9] Interview with Deputy Chief Executive Officer of Co-op Bank, March 2020.

[10] Interview with Lien Viet Postbank for microfinance information, March 2020. Lien Viet Postbank. 2019. *Annual Report 2019*.

providing microloans and deposits. In this paper they will be referred to collectively as "microfinance service providers" or MSPs.

10. Four of the MSPs are officially licensed as MFIs by the State Bank of Vietnam (SBV). These four accounts for 60% of all clients and 70% of all loans in the sector. The MFI license allows them to accept voluntary deposits from the public as well as borrow in foreign currency.

11. In addition to the four licensed MFIs, SBV believes that there could be as many as 400 semiformal MSPs run as social funds or programs of the Viet Nam Women's Union (VWU) or other sociopolitical mass organizations, provincial people's committees, development agencies such as the International Fund for Agricultural Development (IFAD), international nongovernment organizations (NGOs), or community-based organizations. It is difficult to verify the actual number of MSPs because the data is scattered and incomplete. SBV collects comprehensive data on 74 registered MSPs in addition to the four licensed MFIs. VWU collects data on 187 MSPs, although for more than 100 MSPs VWU only has the organization's name but no operational or financial information. The Microfinance Working Group tracks data on 30 of its members, including VBSP, 3 licensed MFIs, 16 registered MFOs reporting to SBV, and 10 other MFPs.[11]

12. Combining these different databases makes it possible to compile data on 100 MSPs, including the four licensed MFIs. It is estimated that as of 2019 they had a combined outreach of 807,000 clients and total loans of D9 trillion ($385 million) (Appendix 1). The smallest institutions for which data is available have just one to two hundred clients and D200 million–D300 million ($10,000–$15,000) in loans. Even if there are 300 other MSPs of similar size as the SBV estimates, they would add at most 30,000–60,000 clients and D70 billion–D100 billion ($3 million–$4.5 million) to the total—less than 10% of clients and about 1% of total loans outstanding. While they may be numerous, their impact on the market is negligible.

B. Assessment of the Microfinance Sector's Growth

1 Government-Supported Systems

13. The microfinance services of the government-supported systems have generally stopped growing, and in recent years some have been losing clients. For example, VBSP's total of seven million clients has remained unchanged for many years. According to VBSP, this is because the bank's credit programs are limited to qualified households. Even as it added new target client segments, to its original focus on the poor or disadvantaged, almost all of those who are eligible are already served. In other words, VBSP is prevented from significantly expanding its outreach by limitations imposed by its mandate.[12] Its dependence on the state budget to fund its loan portfolio is another limiting factor.

14. Within its target market segments, however, VBSP expects demand for credit to increase. Over the past 3 years, its average loan size has risen from D20 million to D25 million (from $870 to more than $1,000), with continuing increases of 10% per annum expected through 2022.

[11] Data on MFIs and MFOs/MFPs for 2017–2018 provided by SBV and VWU in September 2019, and Viet Nam Microfinance Working Group Yearbook 2017.

[12] Interview with Phan Cu Nhan, Director of Communication & International Co-operation Department, Vietnam Bank of Social Policies, 20 March 2020.

15. Similarly, Agribank forecasts its solidarity loan portfolio to grow 8% per annum over the next 3 years, but that growth is expected to be driven by increasing loan sizes, not new clients. The number of solidarity loan borrowers has been on a steady declining trend for several years, and Agribank forecasts this trend to continue. The bank says that it has been losing customers to other banks and finance companies, while the capacity of its field staff to bring in new clients remains weak, especially in remote areas.[13]

16. The PCF system is also in decline. A regulatory increase[14] in the minimum amount of share capital required to join a PCF from D50,000 to D300,000 several years ago led to a freeze in new membership. Many members remain in the system to take advantage of the relatively high interest rate PCFs pay on deposits, and nonmembers also deposit into the system for the same reason. However, PCFs can only lend to members, and fewer are borrowing. Competition may be a factor, but another reason is that the PCFs have not sufficiently invested in membership development. For an increasing number of members, PCFs offer a good opportunity to save but are not the financial institution they rely on for loans (footnote 9).

17. Finally, there has been no growth in LVPB's number of microloan borrowers over the past 3 years, and the outstanding value of its total microloan portfolio fell 8% between 2017 and 2019.[15]

2. Microfinance Systems

18. The financial performance of MSPs as a whole has been satisfactory. As of 2019, licensed MFIs achieved a return on assets of 3%, a return on equity of 13.7%, and had a 30-day portfolio at risk (PAR_{30}) rate of just 0.36%. Unlicensed MFOs and MFPs had a PAR_{30} of 0.45%[16].

19. By other measures, however, the sector is undeveloped. There are only three organizations of significant size: Capital Aid for the Employment of the Poor Microfinance Institution (CEP), Tao Yêu Mày Tinh Thuong One-Member Limited Liability Microfinance Institution (TYM), and Tien Giang Capital Aid Fund for Women's Economic Development (MoM Tien Giang). These three MSPs account for 60% of clients and 69% of loans outstanding. One MFI—CEP in Ho Chi Minh City—accounts for 43% of clients and just over half of all loans in the sector. Below the top tier, another 10 institutions have at least 10,000 clients and D23 billion ($1 million) in loans outstanding, accounting for 20% of clients and 14% of loans outstanding. The large number of small MSPs account for 20% of clients and 17% of loans outstanding.

20. Since the sector is highly concentrated, the largest institutions drive overall growth. However, their track record is mixed. Table 1 shows that only CEP and TYM are growing consistently. The seven large institutions listed in the table account for more than two-thirds (68%) of all clients; together they have managed to increase the number of borrowers by only 2% per year and depositors by 4% per year over the past 3 years.

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[13] Interview with the deputy director of Agribank's Households and Individual Client Division, March 2020.
[14] Circular 04/2015/TT–NHNN on PCFs, Article 28, 31 March 2015.
[15] Interview with Lien Viet Postbank's deputy director of Treasury Division and deputy director of Product Division, March 2020
[16] Hai. Nguyen, Viet Nam Microfinance Center, Banking Academy: Demand for Loans and Difficulties in Mobilizing Capital of Microfinance Organizations. Unpublished.

Table 1: Outreach by Leading Microfinance Service Providers Over the Past 3 Years

Year	Number of Borrowers 2017	Number of Borrowers 2018	Number of Borrowers 2019	Annual Growth Rate	Number of Depositors 2017	Number of Depositors 2018	Number of Depositors 2019	Annual Growth Rate
CEP MFI	320,901	330,330	339,468	3%	285,384	294,731	301,719	3%
TYM MFI	98,086	104,357	103,425	3%	144,390	157,109	165,970	7%
Thanh Hoa MFI	21,515	21,449	20,329	-3%	33,490	38,518	42,040	12%
M7 MFI	10,866	9,675	8,089	-14%	18,899	17,373	15,102	-11%
MoM Tien Giang	43,227	42,492	41,084	-3%	44,136	43,625	42,398	-2%
Quang Binh WDF	14,238	13,991	16,000	6%	n.a.	n.a.	n.a.	0%
Ha Tinh WDF	18,780	18,593	17,428	-4%	21,390	20,872	19,687	-4%
Total	527,613	540,887	585,823	2%	547,689	572,228	586,916	4%

n.a. = not applicable.

Source: Microfinance institutions and microfinance organizations.

21. For the sector as a whole, in the 8 years between the time the government promulgated Decision 2195 in December 2011 through December 2019, the total number of clients served by MSPs grew from 384,000 to 807,000, an annual rate of growth of 11%. While the overall growth rate in the number of clients served may appear satisfactory, the two largest institutions—CEP and TYM—accounted for half of the increase. Most other MSPs are growing very slowly, if at all.

22. A comparison of other countries at similar levels of per capita income shows that Viet Nam's microfinance sector is lagging. For example, Myanmar passed its main microfinance law in November 2011, the same year as Viet Nam's Decision 2195, and its microfinance sector now serves 4.9 million clients (Table 2).

Table 2: Comparison of Microfinance Service Providers (Excluding Cooperatives and Government Banks) by country

Country	Viet Nam	Myanmar	Philippines	Cambodia	Pakistan	Sri Lanka
GDP (nominal)	260,736	71,215	330,910	24,542	314,588	88,901
Population ('000)	96,480	53,708	106,652	16,250	212,215	21,670
Per capita GDP	2,702	1,326	3,103	1,510	1,482	4,102
Official poverty rate	6.7%	21.6%	16.5%	24.3%	29.5%	4.1%
Number of people below poverty line ('000)	6,464	23,037	2,681	13,051	62,603	888
Total microfinance clients	807,000	4,878,270	2,622,517	2,692,407	7,249,943	2,558,365
Microfinance clients, % population below official poverty line	12%	11%	100%	37%	12%	288%
Total microfinance loans ($mn)	385	1,382	1,418	10,312	1,911	431
Microfinance loans, % GDP	0%	2%	0%	42%	1%	0%
Average loan size ($)	477	283	541	3,830	264	169

GDP = gross domestic product.

Note: GDP data is from 2019 and microfinance data is from the third quarter or fourth quarter of 2019, depending on availability. Population and poverty rate data are from 2016 to 2019, depending on availability.

Sources: Bangko Sentral ng Pilipinas, Cambodia Microfinance Association, Myanmar Microfinance Association, Pakistan Microfinance Network, Lanka Microfinance Practitioner's Association, World Bank, and author's calculations.

23. Even the leading MFIs in Viet Nam underperform their peers in other countries. For example, TYM MFI has 20 branches reaching less than 600 of Viet Nam's 11,000 communes. Given that limited footprint, TYM serves just 100,000 active borrowers with an outstanding portfolio of $63 million even though it has been operating for more than 25 years. Viet Nam's largest MFI—CEP—has only 34 branches serving 330,000 active borrowers after nearly 30 years of operations. By contrast, Cambodia has nine MFIs with at least 100 branches capable of serving more than 10,000 of Cambodia's 14,000 villages. Eight of these MFIs have loan portfolios larger than CEP. Similarly, Myanmar's MFIs can serve 23,766 villages—37% of the total. The largest MFI in Myanmar—Pact Global Microfinance Fund—had a loan portfolio of $451 million and served more than a million clients in 16,134 villages as of the end of 2019.

24. It would be incorrect to characterize Viet Nam's microfinance sector as completely stagnant. The total amount of loans outstanding of the seven leading MSPs, which account for 84% of total loans in the sector, grew at an average rate of 20% over the past 3 years. However, CEP and TYM accounted for almost all (93%) of that increase (Table 3).

Table 3: Total Loans Outstanding by Largest MSPs Over the Past 3 Years
(D million)

	Amount of Loans			
Year	**2017**	**2018**	**2019**	**Annual Growth Rate**
CEP MFI	3,057,383	3,757,287	4,488,018	21%
TYM MFI	1,201,478	1,461,456	1,831,628	23%
Thanh Hoa MFI	282,822	330,163	359,594	13%
M7 MFI	141,705	133,946	128,762	-5%
MoM Tien Giang	236,522	276,169	308,659	14%
Quang Binh WDF	134,219	177,065	215,000	27%
Ha Tinh WDF	133,618	145,396	150,659	6%
Total	**5,187,747**	**6,281,482**	**7,482,320**	**20%**

Source: Microfinance institutions and microfinance organizations.

25. MSP leaders interviewed for this assignment explained that their outreach is growing slower than their loan portfolios because they are prioritizing the needs of their existing clients. Two conclusions can be drawn from their response. First, it demonstrates that MSPs have not been able to fully meet the needs of their existing clients, whose demand for loans exceeds what the MSPs can provide. Second, it shows that MSPs prefer to prioritize their existing clients—very often the members of the sociopolitical organizations that control them—rather than seek new ones.

C. Main Constraints on the Sector's Development

26. Based on an analysis of the available data, interviews with three MFIs, 10 MFO and MFPs, and other stakeholders, there are many factors that have led to this poor performance. The two most important binding constraints are (i) limited access to funds and (ii) lack of a commercial mindset.

1. Limited Access to Funds

27. Many MSPs, including the licensed MFIs, began as credit projects that were either stand-alone or part of larger development programs supported by international agencies and NGOs. Initial funding came in the form of a grant or a soft loan.

28. Many MSPs which are still unlicensed by the SBV continue to rely on such sources of funding today. About three-quarters of the portfolios of the unlicensed MSPs is financed by grants and subsidized loans. Unlicensed MSPs have few alternatives. They are limited to accepting voluntary deposits up to 30% of their loan portfolio[17] and are only allowed to mobilize grants from international organizations.[18]

29. Some unlicensed MSPs are still able to access grants from international NGOs, but such funding is in limited supply. As a result, most unlicensed MSPs depend on compulsory savings and retained earnings to finance their growth. They have no alternative: without a license or much to offer for collateral, they are unattractive to banks and investors.

30. Licensed MFIs have more funding options. For example, they can borrow from Vietnamese banks, although their lack of collateral restricts the amount that is available to them. They can borrow from international "social investors" (microfinance investment vehicles [MIVs]) who specialize in making uncollateralized loans to microfinance institutions, but since these loans are usually denominated in foreign currency and carry a commercial interest rate, they tend to minimize such transactions.

31. Instead, MFIs' most important source of funding is deposits, which finance more than half of their portfolios (86% in the case of TYM). Almost all of the growth in loan portfolios shown in Table 3 was driven by deposits and retained earnings. Although, as shown in Table 1, the growth in the number of depositors is outpacing the number of borrowers, it is still very low, thus limiting the ability of MFIs to grow without access to external wholesale funds.

2. Lack of a Commercial Mindset

32. The leaders of several unlicensed MSPs interviewed for this assignment expressed a strong preference for subsidized wholesale loans. In fact, in many cases MSP leaders say they would hesitate to accept a commercial loan even if it were available. In part, they say, this is because commercial loans are too expensive relative to their retail lending rates.

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[17] Decision No. 20/2017/QD–TTg, on *Regulations of Activities of Microfinance Programs and Projects of Political Organizations, Socio-Political Organizations and Non-Governmental Organizations*, Article 13(1)(b).

[18] Although Article 13(1)(c) in the main regulation governing MFOs and MFPs, Decision No. 20/2017/QD–TTg on *Regulations of Activities of Microfinance Programs and Projects of Political Organizations, Socio-Political Organizations and Non-Governmental Organizations*, allows them to borrow from "credit institutions, financial organizations and domestic and foreign organizations in accordance with regulations of law", in practice they raise few funds in this way. Banks are generally wary about lending to them because they are not licensed organizations (in addition to their lack of capital and audited financial statements). In addition, SBV Circular 34/2019/TT–NHNN on Guiding the Management of Foreign-Currency Funding Sources of Microfinance Programs and Projects of Political Organizations, Socio-Political Organizations and Non-Governmental Organizations states that "Political organizations, socio-political organizations and NGOs shall only raise foreign currency funding for microfinance programs/projects in the form of non-refundable aid given by organizations and individuals that are non-residents. Political organizations, socio-political organizations and NGOs are not allowed to mobilize foreign currency funding for executing microfinance programs/ projects in other forms" (Articles 3.1 and 3.3).

33. Indeed, although Banking Academy finds that unlicensed MFOs and MFPs have a maximum interest rate of 18.2%[19] per annum, in general lending rates are low in the sector. For example, as of 1 December 2020, CEP's loans to members of the Ho Chi Minh Labor Federation, which is also CEP's owner, carried an interest rate of 0.4% per month flat (8.75% per annum). Loans to non-union members, including microenterprises, carried a rate of 0.74% per month flat (16.0% per annum).[20] Likewise, TYM's lending rates ranged from 0.08%/week to 0.19%/week flat,[21] or 7.60%–17.75% per annum.

34. These lending rates are low by international standards, and they are also low relative to other interest rates in the domestic economy. For example, SBV Decision 1728/QD–NHNN, dated 30 September 2020, sets the refinancing rate for banks at 4% per annum. Rates on retail loans to SMEs are also comparable to microfinance rates even though, unlike MFI clients, SMEs must be registered and provide financial records and collateral to obtain financing at these rates.[22]

35. Although SBV caps some interest rates, low lending rates in the microfinance sector are the choice of the providers, not the result of policy. Article 13(2) of SBV Circular 39/2016/TT–NHNN, dated 30 December 2016, regulates the lending transactions of credit institutions and stipulates that only short-term interest rates for prioritized sectors are subject to a cap, which was 5.5% per annum in September 2020.[23] Short-term loans are defined in Article 10 as loans having the maximum loan term of 1 year.[24] However, MFIs routinely avoid being subject to this rule by issuing loans with a term of 1 year plus 1 day.

36. Delivering loans at such low interest necessitates a low cost of capital. MFIs like CEP and TYM mainly rely on deposits to fund their portfolios. Currently, they pay about 3% or less on compulsory and demand deposits by their customers, and offer long-term deposits with a maximum rate of less than 6% for a 36-month term (Box 1). As with their lending rates, although SBV caps some deposit rates, these low deposit rates are the choice of the providers, not the result of policy. SBV only regulates the maximum rate credit institutions pay on time deposits of less than 6 months in term, and MFIs pay less than the cap, which was 4.5% in September 2020.[25]

37. This low cost of capital enables MFIs, MFOs, and MFPs to offer loans at relatively low interest rates to their customers, many of whom are members of the sociopolitical organizations that own them. These low rates are not required by regulation, but instead are the result of historical practice. Customers have become used to such rates, and MSP leaders say they will not accept an increase. This was also the case in many other countries with similar histories of the sector's development, but they transitioned to

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[19] Hai. Nguyen, Viet Nam Microfinance Center, Banking Academy: Demand for Loans and Difficulties in Mobilizing Capital of Microfinance Organizations. Unpublished.

[20] Khoa Anh. 2020. *CEP Interest rate adjustment from 01/12/2020*.

[21] TYM. 2020. *Financial Products*.

[22] Thao Nguyen. 2021. *Viet Nam banks promote loans with low interest rates by year-end*. BIDV, the largest lender to SMEs in Viet Nam, offers preferential rate starting from 5% per annum for loans with maturity under 6 months and 5.5% for loans from 6 to 12 months, while Agribank offers SMEs annual rates of 4.8% for short-term loans and 7.5% for mid- and long-term loans. BIDV. 2020. *BIDV reinforces SMEs with lending rate from 6% p.a. only* The rate on subsidized loans offered through the SME Development Fund is 6% per annum.

[23] SBV lowered the cap from 7% in November 2019 to 6.5% in March 2020, 6% in May 2020, and 5.5% in September 2020. In general, SBV sets the maximum allowable rate for MFI short-term loans to prioritized sectors 1 percentage point higher than the cap on banks' short-term lending rates. See SBV Decision 418/QD–NHNN dated 16 March 2020, Decision 918/QD–NHNN dated 12 May 2020 and Decision 1730/QD–NHNN dated 30 Sept 2020.

[24] Medium-term loans are legally defined as having a term of 1–5 years, and long-term loans have terms of more than 5 years.

[25] The cap on MFI rates on deposits of less than 6 months in maturity was 4.5% in September 2020, down from 5.5% in November 2019, 5.25% in March 2020, and 4.75% in May 2020. Refer to SBV's Decision 2415/QD–NHNN dated 18 November 2019, SBV's Decision 419/QD–NHNN dated 16 March 2020, Decision 919/QD–NHNN dated 12 May 2020, and Decision 1729/QD–NHNN dated 30 September 2020.

a more commercial model that enabled them to remain profitable while borrowing at commercial rates. Since this has not happened in Viet Nam, the result is that MSPs are in a bind: they are loathe to raise interest rates or increase their fees,[26] but cannot find sufficient low-cost capital to be able to grow under such circumstances.

Box 1: Cost of Capital at Leading Microfinance Institutions

At Tao Yêu Mày Tinh Thuong One-Member Limited Liability Microfinance Institution (TYM), deposits financed 86.4% of its loan portfolio in 2019. Its largest source, 26% of its deposits, was the compulsory savings of members, on which it pays 3.2% per annum. Another 14% of deposits were members' flexible savings, which earn 0.2% per annum. The majority of its savings, 58%, were term deposits carrying interest rates ranging from 3.5% to 6.0% per year.[a]

In the same year, Capital Aid for the Employment of the Poor Microfinance Institution (CEP) financed 56% of its portfolio through deposits. The single largest source, 38% of the total, was customers' compulsory deposits, on which CEP paid 0.1% per month (1.2% per annum).[b] Customers' voluntary deposits accounted for 19% of the total, and CEP paid 0.25% per month (3.0% per annum) on them.[c] Another 33% of external funding came from institutional deposits, almost all from state-owned enterprises, on which CEP paid an average of 2.9%. Finally, 3% of CEP's portfolio was financed through loans from the Ho Chi Minh Labor Federation and international microfinance investment vehicles, on which it paid an average rate of 9.4%.[d] Currently, CEP offers rates under 6% per annum for 36-month term deposits.[e] Overall, in 2019 CEP incurred a total cost of capital of 3.7%,[e] versus a gross portfolio yield of 15.9%.

[a] TYM. 2021. *Financial Products*, and TYM. 2020. *TYM 2019 Performance Report*.
[b] CEP. 2018. *Tiết kiệm theo khoản vay.* CEP's practice is to require borrowers to set aside 1% of their loan proceeds as a compulsory deposit, which simultaneously helps secure the loan and encourage clients to save. 92% of compulsory deposits were made by microentrepreneurs and only 8% by members of the Ho Chi Minh Labor Federation, even though loans to labor federation members account for 44% of total loans.
[c] CEP. 2020. *Tiết kiệm định hướng*.
[d] CEP. 2020. *Audited Financial Statements 2019*.
[e] CEP. 2020. *TiYP ggY tiiP kiiP bbiP điP ViiP Nam tNa TT chhm tài chính vi mô.* Total interest expenses of D111 billion on an average outstanding deposits and loans of D2,995 billion.

Source: Compiled by the authors

38. Even if they were interested in a commercially priced loan, few MSPs could qualify because they are unable to produce business plans and other documents required for lenders' credit committees. For licensed MFIs, a credit rating is also helpful for unlocking funding, yet none of the licensed MFIs have had a credit rating in more than a decade.

39. These are all indications that MSPs are not commercially oriented. In fact, most MSP leaders pursue a strategy more like an NGO than a business. Few of them have a background in business or finance. While they may be experienced in social and advocacy issues, they often lack the knowledge and skills necessary to develop an overall growth strategy, or guide, and advice on operational issues.

40. The absence of a commercial mindset among MSPs is the main reason there are still significant gaps in MSP operational capacity despite years of training and technical support. Without strong leadership, most MSPs are left with limited human resource management systems. Accounting

[26] MFIs in many countries, especially those with a cap on lending rates, charge fees to generate additional revenue. SBV has not issued any regulations limiting the fees that MFI can charge.

and financial management, while adequate for small-scale operations, cannot support expansion. Management information systems, required to manage risk and to provide reports to the SBV that are one of the conditions for receiving a license, are also generally inadequate. Finally, even though MSPs deliver financial services in the field through their own staff, they often still rely on the VWU for fundamental processes such as identifying and assessing potential clients and reminding them of repayment.

41. Given the absence of clear growth strategies, audited financial statements, and dynamic internal capacity, banks and other wholesale lenders interviewed for this assignment expressed concern about the creditworthiness of most MSPs. In other words, the lack of supply of wholesale funds is because of more than a lack of collateral.

42. Instead, it is a symptom of a wider, systemic problem. Although the quality of management varies enormously in any microfinance market, Viet Nam is unique in that it is a large potential market and has so few MSPs of scale. Whatever the reason, the result is that Viet Nam's microfinance sector resembles global microfinance 15 years or 20 years ago when NGOs financed by subsidized credit were the norm.

D. Assessment of Decision 2195 and Microfinance Regulations

43. The underperformance of Viet Nam's microfinance sector over the past decade is surprising given that Decision 2195 was expected to create an enabling environment that would allow it to grow much faster than it did. In fact, many of the stated goals in Decision 2195 were achieved: the legal environment was enhanced with the creation of a licensing framework, SBV's supervisory capacity was strengthened, and training programs were delivered to MSPs. To the extent that growth has been steady and there have not been default crises or a bankruptcy among the MSPs, the Decision's overall objective, "to build and develop a safe and sustainable microfinance system", was achieved.

44. Yet the sector's slow growth indicates that there is still room for further policy and regulatory improvements. Although there is a licensing framework and SBV's supervisory capacity has been strengthened, only four MFIs have been licensed. There are at least 10 MFOs and MFPs that meet the condition for licensing: D50 billion ($2.1 million) in loans.[27] There are many reasons a commercially oriented MSP should want a license: access to deposits, more secure legal status, access to the interbank market, and more trust from clients and lenders because of SBV supervision. Moreover, the regulations state that MSPs of certain size are required to transform or otherwise scale down their operations.[28] Nevertheless, these organizations have not applied for a license because of the additional managerial and operational requirements that licensing entails.

45. Another twenty MFOs and MFPs have D25 billion–D50 billion ($1 million–$2 million) in loans outstanding.[29] They cannot meet the requirements for a license but are still sizable institutions operating outside SBV's supervision. One important gap in the regulatory framework is that no distinction is made between deposit-taking and nondeposit taking MFIs, with a lower capital requirement for the latter.

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[27] Decision 20/2017/QD–TTg, Article 15 states a domestic political organization, socio-political organization or NGO will convert its microfinance program into a micro institution if one of the following conditions is fulfilled: (i) total value of assets of the microfinance program is at least D75 billion, and (ii) the total loans which microfinance clients have not repaid to the microfinance program are at least D50 billion.

[28] Ibid.

[29] Data on MFIs and MFOs/MFPs for 2017–2018 provided by SBV and VWU as of September 2019, and Viet Nam Microfinance Working Group Yearbook 2017. A ranked list of MSPs with their number of clients and total loans outstanding is in Appendix 1.

Such a tiered approach, which is common in other countries, would create a pathway for smaller MFOs and MFPs to become licensed.

46. Decision 2195 also intended to address the two main constraints on the sector's growth described in Section C above (paragraphs 26-42) but the sector continued to underperform. To some degree, this was because Decision 2195 was a high-level strategy document, and not all of the guidelines and circulars required to implement it were issued. However, even if all implementing rules and regulations had been issued, the outcome may not have been much different. The root cause of the sector's underperformance was not Decision 2195 but the legal and regulatory environment in which it was enacted. Although the regulations for licensed MFIs (Circular 03/2018/TT–NHNN) and unlicensed MFOs and MFPs (Decision 20/2017/QD–TTg) differ in numerous ways, they share an underlying conceptual framework for organizing the sector, as well as similar provisions that contribute to the sector's limited access to funding and lack of commercial mindset described in Section C above (paragraphs 26-42).

1. Limited Access to Funds

47. Decision 2195 directly addressed the need for funding. The Ministry of Planning and Investment was mandated to support microfinance institutions to access preferential capital. The Ministry of Finance was tasked with the following:

(i) Propose solutions for the improvement of the preferential credit mechanism to properly serve the poor and policy beneficiaries.
(ii) Advise the government on capital sources for microfinance.
(iii) Propose policies to create conditions for sociopolitical organizations to use preferential credit sources for microfinance activities.

48. With the end of Decision 2195's implementation period approaching, it is clear that such funds were not raised in sufficient supply to fuel growth in the sector. However, this outcome is not the fault of the ministries in charge. Rather, it is because the "preferential" credit the strategy prioritized is rarely available.

49. Some international NGOs still provide such funding, although their resources are limited. Development agencies provide grants and subsidized loans to help start up farmer associations and other informal groups that are part of their grassroots projects, but they phased out that kind of funding for MSPs after 2010, when it became clear from international precedents that microfinance could be sustainable and growth-oriented. Those that still do offer commercial terms similar to private investors.

50. As development agencies and NGOs phased out their microfinance wholesale lending, MIVs took their place. There are more than 100 such sources of funds around the world with nearly $17 billion under management.[30] They are the main source of wholesale funding to microfinance institutions today, but they have not been able to do much business in Viet Nam because only the four licensed MFIs can borrow in foreign currency, and the cost of the loans makes them reluctant to borrow.

[30] Symbiotics. 2019. *2019 Symbiotics Microfinance Investment Vehicles (MIV) Survey*.

2. Lack of a Commercial Mindset

51. Decision 2195 placed considerable emphasis on training to address capacity constraints among MSPs. Training can be beneficial, although its effectiveness is limited if there is no follow-up technical assistance to ensure that what was taught in the classroom is implemented in practice. This is a very common situation. Cambodian MFIs, for example, often relied on foreign chief executive officers and/or in-house foreign technical assistants for many years to build their capacity, and many of Myanmar's MFIs still did so as of the end of 2019.

52. In fact, training and capacity-building activities have been delivered to Vietnamese MSPs for more than two decades. Although training can help, it can only affect change within the existing policy environment, which is currently oriented toward a nonprofit-driven microfinance sector.

53. This nonprofit orientation can be traced to the regulatory mandate that all MSPs must be controlled by a sociopolitical organization. It is the single greatest factor limiting the growth of the sector because few of those organizations are able to nominate steering committee members or managers who specialize in financial services or have a background in business. In fact, the regulatory minimum qualifications are low and enable sponsoring political or sociopolitical organizations to promote their own members to leadership positions. The prevalence of leaders with backgrounds primarily from sociopolitical organizations hampers both the professionalization of management and the flow of new ideas into MSPs.

54. This requirement has been imposed largely because there is a concern that an overly commercial approach could mean MSPs drift from their mission of serving poor and disadvantaged groups. Mission drift was a major concern globally a decade ago when commercialization accelerated, but the evidence shows that the professionalization of microfinance service providers does not necessarily lead to mission drift. In Cambodia, for example, while some MFIs have indeed shifted their focus toward less-poor clients, others have maintained their pro-poor focus even has they have grown into national-level institutions.

55. In other words, mission drift is MSP-specific, not a sector-wide phenomenon. The boards and management of the socially oriented MFIs are just as professional as their counterparts at the more commercial MFIs. The difference is that they have committed themselves to achieving social goals and actively monitor their performance. Similarly, Myanmar has experienced significant growth in its microfinance sector between 2011 and 2019 without mission drift since reforms allowed commercial providers to be established.

56. If there is a concern about mission drift, Article 120(2) of the Credit Institution Law already provides SBV with a tool to minimize it:

> Microfinance institutions shall maintain a ratio between total outstanding credits to low-income individuals and households, super micro enterprises and total outstanding credit of microfinance institutions not to be lower than a ratio stipulated by the State Bank.

57. There is a number of additional ways for preventing mission drift, such as requiring social performance and client protection audits, rather than strictly limiting which organizations can control an MSP. Viet Nam's control-based approach to ensuring a pro-poor and/or social focus has stymied the growth and development of the sector. Without growth, outreach by microfinance service providers will remain limited and inefficiencies because of poor economies of scale will not be addressed. This means that Viet Nam's current approach to microfinance actually limits the sector's contribution to the government's social goals.

3. International Comparisons

58. Another approach to evaluating the legal and regulatory environment in Viet Nam is to compare with other countries with well-developed microfinance sectors. The main source for this information is the Global Microscope on Financial Inclusion, published annually by the Economist Intelligence Unit.[31] The Microscope specifically measures the "enabling environment" for financial inclusion, in which microfinance plays a central role.

59. The Microscope ranks countries on a number of factors. In the October 2019 report, its ranking of the countries with the best "government and policy support for financial inclusion" included seven countries in Latin America, four in Asia, and two in Africa (Table 4). Viet Nam ranks 32 out of 55 countries surveyed.

Table 4: 2019 Microscope on Financial Inclusion Ranking for Government and Policy Support for Financial Inclusion

Rank	Country
1	Colombia
2	Mexico
3	Rwanda
4	Tanzania
5	Peru
6	El Salvador
7	Argentina
8	India
8 (tie)	Uruguay
10	Brazil
10 (tie)	Nepal
10 (tie)	Pakistan
10 (tie)	Philippines

Source: Economist Intelligence Unit.

60. A comparison of the legal and regulatory requirements in Viet Nam versus countries ranked high in the Microscope for their government and policy support (Colombia, Mexico, Peru, Rwanda, and Tanzania) is provided in Appendix 2. A comparison between Viet Nam and Asian countries with large microfinance sectors (Thailand, Cambodia, Myanmar, the Philippines, and India) is provided in Appendix 3.

61. While it may be fruitful to compare specific details in each country's regulatory framework, in practice the rules about licensing requirements, prudential requirements, or the organizational structure of MSPs are highly dependent upon idiosyncratic characteristics of each country's economy and financial system. There is no deep value in comparing the minimum capital requirement of a deposit-taking MFI in one country versus another.

[31] The Economist Intelligence Unit has been publishing the *Global Microscope* since 2009.

62. Appendix 2 shows that the countries with the best government and policy support for financial inclusion have several characteristics in common:

(i) They allow for a wide variety of specialized licensed and unlicensed institutions, including banks, nonbanks, and NGOs.
(ii) Barriers to entry, such as minimum capital requirements, are low.
(iii) Foreign capital (ownership and loans) is allowed.
(iv) There are few restrictions on the operations of microfinance service providers.

63. As shown in Appendix 3, the major Asian microfinance countries generally follow this approach, albeit with more restrictions:

(i) A variety of institutional types are allowed, including specialized banks.
(ii) Barriers to entry, such as minimum capital requirements, are low.
(iii) Most countries allow foreign ownership and foreign loans.
(iv) Loan size limits, interest rate caps, and other restrictions or mandates on operations are imposed to encourage MSPs to serve the poor and to expand to unbanked areas.

64. Viet Nam has taken a hybrid approach, combining the restricted private sector model common in other Asian countries with government-led financial inclusion. The problem, however, is that Viet Nam has not fully implemented either strategy. For example, VBSP is smaller than Malaysia's Bank Simpanan Nasional. Co-Op Bank is a fraction of the size of Thailand's Bank for Agriculture and Agricultural Cooperatives and Malaysia's Bank Rakyat.[32] On the other hand, Viet Nam's nongovernment MSPs serve only a fraction of clients compared to peer organizations in other Asian countries. Essentially, Viet Nam's government-supported systems have not been provided with the financial and technical support they need to continue growing, while the nongovernment microfinance systems have had too many restrictions placed on their growth.

65. Recommendations for regulatory reform to align the framework in Viet Nam with international best practices and promote the sector's growth are provided in section V of this paper.

[32] Malaysia's cooperative sector is much larger than that in Viet Nam, with 6 million members and $35 billion in assets. However, since 2000, Malaysia has mainly relied on government banks such as Bank Simpanan Nasional, Agrobank, and Bank Rakyat to expand financial inclusion. Its main MFIs—Amanah Ikhtiar Malaysia, Yayasan Usaha Maju, and Economic Fund for National Entrepreneurs Group—were also all created and financed by national or state governments. The largest, Amanah Ikhtiar Malaysia, is larger than CEP, with 400,000 clients and RM2.6 billion ($630 million) in assets.

II. EVALUATION OF THE DEMAND FOR WHOLESALE FUNDS

66. MSPs need financing to grow and expand their impact, although they must also have strong internal systems in order to manage that growth. Estimating the potential demand for microfinance wholesale funds is therefore a function of two variables. The first is the unmet demand for microcredit. The second is the capacity of MSPs to grow and meet that demand. In Viet Nam the latter is clearly the main constraint.

A. Base Scenario

67. The base case for MSPs' demand for funds is their historical demand. If the leading MSPs maintain the growth rate from 2017 through 2019 over the next 5 years while maintaining the same funding reliance on deposits and retained earnings, they would need D2 trillion ($86 million) in external wholesale funds (Table 5).

Table 5: Estimated Demand for Wholesale Funds Based on Recent Portfolio Growth Trends
(D million)

	Total Portfolio 2019	Annual Growth Rate (2017–2019)	Total Portfolio After 5 Years of Similar Growth	Increase in Portfolio in 5 Years	Percent of Portfolio Financed from Deposits and Retained Earnings	Estimated Amount of Wholesale Funds Needed
CEP MFI	4,488,018	21.2%	11,717,001	7,228,983	80%	1,445,797
TYM MFI	1,831,628	23.5%	5,255,825	3,424,197	90%	342,420
Thanh Hoa MFI	359,594	12.8%	655,482	295,888	75%	73,972
M7 MFI	128,762	–4.7%[a]	161,818	33,056	90%	3,306
MoM Tien Giang	308,659	14.2%	600,478	291,819	95%	14,591
Quang Binh WDF	215,000	26.6%	698,232	483,232	80%	96,646
Ha Tinh WDF	150,659	6.2%	203,386	52,727	50%	26,363
Total	**7,482,320**	**20.1%**	**19,292,222**	**11,809,902**		**2,003,094**

[a] Calculations use +5% growth for M7MFI for the coming 5 years.

Sources: Microfinance institutions, microfinance organizations, and author's calculations.

B. Accelerated Growth Scenarios

68. If the reforms for enhancing the professionalism and commercial mindset of MSPs are enacted and if wholesale funding is not a constraint, it is likely that the MSPs could grow faster than the most recent trend. Additional funding would allow them to continue serving their existing clients and reach out to new clients. Under a scenario in which growth is 20% faster than the base scenario, the demand for wholesale funds would be D2.6 trillion ($112 million) (Table 6).

Table 6: Estimated Demand for Wholesale Funds Based on Accelerated Portfolio Growth
(D million)

	Total Portfolio 2019	Accelerated Annual Growth Rate (20% faster than base scenario)	Total portfolio after 5 Years of Accelerated Growth	Increase in Portfolio in 5 Years	Percent of Portfolio Financed from Deposits and Retained Earnings	Estimated Amount of Wholesale Funds Needed
CEP MFI	4,488,018	25.4%	13,911,174	9,423,156	80%	1,884,631
TYM MFI	1,831,628	28.2%	6,333,786	4,502,158	90%	450,216
Thanh Hoa MFI	359,594	15.3%	733,083	373,489	75%	93,372
M7 MFI	128,762	5.6%	169,178	40,416	90%	4,042
MoM Tien Giang	308,659	17.1%	679,135	370,476	95%	18,524
Quang Binh WDF	215,000	31.9%	857,615	642,615	80%	128,523
Ha Tinh WDF	150,659	7.4%	215,512	64,853	50%	32,427
TOTAL	**7,482,320**		**22,899,482**	**15,417,162**		**2,611,734**

Sources: Microfinance institutions, microfinance organizations, and author's calculations.

69. However, even under this accelerated growth scenario, the impact on financial inclusion would still be limited. Assuming that the higher growth rate in the accelerated growth scenario in Table 8 compared to the base growth scenario in Table 7 is driven entirely by new client acquisition, the seven leading MSPs would add only 125,000 clients over 5 years (Table 7).

Table 7: Estimated Increase in Client Outreach Under 'Accelerated Growth' Scenario

	Total Borrowers 2019	Annual Growth Rate in Number of Clients (2017–2019)	Growth Rate in Number of Clients in Accelerated Growth Scenario	Total Borrowers After 5 Years of Accelerated Growth	Increase in Borrowers in 5 Years
CEP MFI	339,468	2.9%	4.2%	417,634	78,166
TYM MFI	103,425	2.7%	4.7%	130,087	26,662
Thanh Hoa MFI	20,329	-2.8%	2.6%	23,058	2,729
M7 MFI	8,089	-13.7%	10.3%	13,199	5,110
MoM Tien Giang	41,084	-2.5%	2.8%	47,275	6,191
Quang Binh WDF	16,000	6.0%	5.3%	20,727	4,727
Ha Tinh WDF	17,428	-3.7%	1.2%	18,533	1,105
Total	**585,823**	**1.7%**		**670,513**	**124,690**

Sources: Microfinance institutions, microfinance organizations, and author's calculations.

70. Compared to an increase of 125,000 clients over 5 years, the National Financial Inclusion Strategy (NFIS) targets that at least 70% of adults will have a credit history in the credit registry of the SBV, indicating that 70% of adults will have borrowed from a formal institution by 2025. The most recent data on the extent of financial inclusion in Viet Nam is from 2017: The World Bank's FinDex survey (data was gathered in 2016). At that time, 31% of adults had a bank account, and 21% had borrowed from a financial institution. To achieve a target of 70% borrowing formally in an adult population of 60 million means banking 24.6 million more people. Currently, total MSP clients are about 1.3% of the adult population. If they conservatively

maintain this ratio, which would imply that the microfinance sector's outreach remains constant rather than expanding, they would need to add 320,000 new clients by 2025 to contribute proportionally to the NFIS.

71. The seven leading MSPs would need to grow their client bases by 9.1% per annum to add 320,000 clients in 5 years, which is a significant increase over the current growth rate of 2%. Based on the current funding patterns, they would need D3.6 trillion ($155 million) in external wholesale funding to achieve that growth.

72. Moreover, even 320,000 clients would be a small portion of the financially excluded and underserved population. The most recent data on demand for credit among microentrepreneurs is from 2017. It is estimated that there are 845,953 establishments that need D44 trillion ($1.9 billion) in finance. The average loan size for the microenterprises who need finance 4 years ago was already D52 million ($2,243), above the current regulatory limit of D50 million for microfinance loans.[33] In addition to these microenterprises, there is probable demand from some of Viet Nam's smallholder farming households, which the Government Statistics Office 2019 Statistical Yearbook counted at 14 million.

73. While it is true that Viet Nam has experienced a relatively rapid decline in the proportion of its population living below the poverty line in recent years, the number of potential microfinance clients has not declined. Microfinance clients also include near-poor households, households having average living standards, and individuals having low income or a microenterprise who otherwise are unable or unwilling to use commercial banks. Even with the expansion of services by VBSP and some consumer finance companies, many are still unbanked, and even those with an account at a bank may still be underbanked if the bank's products and services are not appropriate for their needs.

C. Conclusion

74. Without the benefit of a nationwide demand survey, it is difficult to provide an accurate calculation of the unmet demand for microcredit. Nevertheless, the available evidence indicates that demand for microcredit from small businesses and smallholder farmers is probably substantially higher than the funds currently supplied to them.

75. However, even if they have access to more wholesale funds, the incumbent MFIs, MFOs, and MFPs are capable of meeting only a small portion of this unmet demand. They have limited footprints: CEP and TYM have just 34 and 20 branches, respectively, while the other two licensed MFIs have less than five branches, and almost all MFOs and MFPs operate in a single municipality or province. Their ability to expand will continue to be constrained if no legal and regulatory reforms are enacted.

76. They are also exceptionally cautious: according to Banking Academy research,[34] as of 2019 MFIs have capital adequacy of 32.6%, more than three times the regulatory minimum and PAR_{30} below 1%. Contrary to signs of financial strength, these figures suggest a sector that is risk-averse and unable to deploy all of the funds it currently has available to it.

77. In other words, the main factor limiting outreach—and the demand for wholesale funds—is the rate at which the leading MSPs can grow prudently. Since there are currently few large MSPs capable of strong growth, a faster increase in outreach and financial inclusion requires not only growth among the existing MSPs but the entry of new MSPs into the market.

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[33] International Finance Corporation. 2017. *MSME Financing Gap*.

[34] Hai. Nguyen, Viet Nam Microfinance Center, Banking Academy: Demand for Loans and Difficulties in Mobilizing Capital of Microfinance Organizations. Unpublished.

III. POTENTIAL SOURCES OF FUNDS FOR MICROFINANCE WHOLESALING IN VIET NAM

78. MSPs in Viet Nam have four main potential sources of funding: two from the private sector (Vietnamese banks and international MIVs) and two from the public sector (the state budget of the Government of Viet Nam and international development agencies).

A. Private Sector Sources of Microfinance Wholesale Funding

1. Vietnamese Banks

79. The leading MFIs in Viet Nam have received funding from Vietnamese banks. The main domestic wholesale provider is Viettin Bank, which has lent a total of D230 billion ($10 million) to CEP and TYM. Additionally, Saigon Bank has lent to CEP and Military Bank to TYM, but these were special loans, and neither bank plans to develop a specialization in providing wholesale loans to MSPs.

80. Although banks are legally allowed to make loans to MFOs and MFPs, since they cannot meet eligibility requirements (secure legal status, audited financial statements, and collateral) in practice banks do not provide institutional loans to them.

81. Even if one of the banks were to develop wholesale lending as a business line, the impact would be limited unless their lending practices change. Licensed MFIs who apply for loans from banks must have sufficient charter capital and pledge collateral worth at least 100% of the loan size. They often do this by pledging the cash on their balance sheet, the source of which is often the deposits of the clients, so the loans have minimal impact on the MFIs' liquidity. However, few alternative sources of collateral to back a bank loan are available. The Ho Chi Minh City Labor Federation tried to use land that it owns to back a loan to CEP, but the bank would not accept it as collateral. As a result, banks have so far played only a marginal role in financing MSP growth.

82. MSP leaders and other sector stakeholders identify their lack of access to the interbank lending market as hampering their ability to borrow from banks. SBV's Circular 18/2016/TT–NHNN,[35] dated 30 June 2016, allows licensed MFIs to participate in lending and borrowing transactions in Article 1.1. However, Article 1.2.1 (b) requires all transacting institutions to have "internal regulations on professional processes, risk management processes for lending and borrowing activities (at least including regulations on customer credit rating, process of determining loan limits, the process of lending and borrowing transactions, applicable to each specific transaction form)." Licensed MFIs have difficulty complying with this requirement, and since MFOs and MFPs are not licensed or supervised, they cannot participate in the interbank market at all.

83. There is no doubt that access to the interbank market has its benefits. It can help an MFI manage liquidity and build relationships with banks. These are additional factors that should normally incentivize MFOs and MFPs to apply for an MFI license. Nevertheless, interbank lending in Viet Nam is designed for liquidity management, not for financing a loan portfolio. Article 1.2.2 (a) and (b) of Circular 18/2016/TT–

[35] Circular 18/2016/TT–NHNN amends Circular 21/2012/TT–NHNN on *Regulating Lending, Borrowing, and Buying and Selling of Valuable Papers Between Credit Institutions and Foreign Bank Branches.*

NHNN says that institutions transacting on the interbank market must not have debts with other credit institutions or foreign bank branches longer than 10 days, except for those that are under special control or restructuring. Access to this market will not provide the long-term funds that MSPs need to grow.

2. International Microfinance Investment Vehicles

84. International MIVs are the primary source of wholesale funds for MSPs globally. There are 121 MIVs, most of which are based in Europe (Switzerland, the Netherlands, and Germany in particular) with nearly $17 billion under management (footnote 30).

85. Their funding, in turn, comes from both institutional and individual investors, attracted by the contribution to poverty reduction and the reasonable financial returns. Gross returns, excluding the MIVs' operating expenses, average 7%–8% per annum.[36]

86. The benefit of MIVs is that they understand the business model of MSPs and they specialize in making uncollateralized wholesale loans to them. However, they have made very few loans in Viet Nam: Oikocredit of the Netherlands has lent to TYM and Thanh Hoa; Triple Jump and Rabobank Foundation of the Netherlands have lent to CEP as well as TYM; Blue Orchard of Belgium has lent to TYM; BoPA of Japan has invested and lent to Thanh Hoa; and BNP Paribas (through its Ha Noi branch) has lent to CEP, TYM, and Thanh Hoa.

87. The limited presence of MIVs in Viet Nam is mostly a function of weak demand. Although MFIs need funds to expand, they hesitate to borrow from MIVs who charge commercial rates (usually in the range of 8%–10% for loans in United States dollars). Although 43% of MIV debt funding globally is in local currency (footnote 30), hedged loans carry much higher interest rates than those denominated in United States dollars or euros. MIVs also tend to make large loans—the average loan size is nearly $3 million (footnote 30)—that many Vietnamese MSPs cannot absorb.

88. As a result, even the well-established MFIs still rely on subsidized loans from NGOs like Cordaid, Ford Foundation, and Kiva. The regulatory ban on unlicensed MFOs/MFPs foreign currency borrowing also dampens MIV activity in Viet Nam, although changing this regulation would have only a modest impact since most MFOs and MFPs are not considered "bankable"—managed by professionals, with secure legal personality, strong internal systems (including MIS), and reasonable profitability.

B. Public Sector Sources of Microfinance Wholesale Funding

1. State Budget of the Government of Viet Nam

89. VBSP is by far the largest provider of microcredit in Viet Nam, and it is financed principally by a combination of deposits, direct infusions from the state treasury, and government-guaranteed bonds. While these sources may be conceptually viable ways to finance MSPs, they subject the sector's growth to the political process.

90. Further, there are limits on public spending and budgetary rules that exclude some initiatives. For example, the Law on Public Debt Management of 2017 places stringent limits on loans that qualify

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[36] Footnote 30, p. 11.

for a government guarantee, and no longer allows credit institutions (except policy banks) to qualify for government guarantees at all.[37] The Law on Public Assets stipulate that public assets that established from state funds or assigned by the state cannot be used as collateral to back a loan.[38]

2. International Development Agencies

91. Multilateral and bilateral international development agencies were the main source of wholesale funds for MSPs during the 1990s when the modern microfinance movement was in its infancy. After Muhammad Yunus and Grameen Bank were awarded the Nobel Peace Prize in 2006, private investment in MIVs grew. International development finance institutions (DFIs) reduced their support for microfinance but did not exit the market entirely. Some multilateral DFIs such as the Asian Development Bank (ADB)[39] and the International Finance Corporation (IFC),[40] and some bilateral agencies such as German development cooperation through KfW and Proparco of France[41] still provide loans and guarantees to MSPs. Organizations like IFAD still provide grants for self-help groups and village revolving funds.

92. However, DFIs increasingly provide their support through MIVs. About 17% of all current MIV funding comes from public sector institutions (footnote 30). For example, the Microfinance Initiative for Asia (MIFA) debt fund that was established in 2012 by the IFC and KfW has $170 million in funds that are managed by the Belgian MIV Blue Orchard. MIFA funding is available for Viet Nam, but as of September 2020 less than 1% of its assets had been lent to MFIs in the country because of the same reasons that limit other MIV lending.[42]

93. It is possible for licensed MFIs in Viet Nam to access a private loan from a DFI, yet there have been few examples. On the one hand, DFIs generally require the borrowing entity to have secure legal status, strong governance and management, and a viable strategy and business plan. Few Vietnamese MSPs meet these criteria. On the other hand, DFI loans typically are in a foreign currency, include commercial loan covenants, and carry commercial or semicommercial interest rates, all of which are deterrents to MFIs that are accustomed to concessional funding. Viet Nam's improving economic status means that it is no longer classified as a low-income economy, making Vietnamese borrowers ineligible for some sources of concessional financing.

C. Rationale for Combining Public and Private Sector Funds

94. The unique and complex nature of microfinance in Viet Nam—characterized by a wide variety of institutional types at various stages of organizational development—makes it likely that several sources of funds will be needed to meet the sector's wholesale financing needs. Licensed MFIs that can mobilize deposits and access international MIV funding have different needs than MFOs and MFPs. The more professional MFO and MFPs have different needs than the more socially oriented lenders.

95. Importantly, a public-sector driven wholesale finance mechanism alone is not sufficient for Viet Nam. As the demand analysis in section II demonstrates, the need for wholesale funds is too great

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[37] The Law No. 20/2017/QH14 on Public Debt Management, Article 43, November 2017.
[38] The Law No. 15/2017/QH14 on Public Assets, Article 54.5, June 2017.
[39] Sok Chan. 2018. *ADB invests in SME Financing*.
[40] IFC. 2013. *IFC Makes First Investment in Myanmar, Expanding Access to Finance and Creating Jobs*.
[41] Proparco works to support the emergence and development of strong and responsible actors: MFIs, banks, and funds investing in the microfinance sector. www.proparco.fr/en/page-thematique-axe/microfinance.
[42] BlueOrchard Finance. 2021. *Microfinance Initiative for Asia (MIFA) Debt Fund*.

to be financed from the state budget alone. The goal of public funding should be to create incentives for private sector lending and fill the gaps in the market that the private sector is unwilling to cover.

IV. INTERNATIONAL WHOLESALE LENDING MODELS

A. Overview

96. The two main constraints on microfinance service providers identified in section I—lack of a commercial mindset and lack of access to funding—are not unique to Viet Nam. Many other countries faced similar situations as the limits to the NGO-led model became apparent. The countries that have successfully transformed to a commercial-oriented sector without sacrificing the underlying objective of reducing poverty began their transition with regulatory reforms. Regulatory reform created an environment in which MSPs could professionalize, and access to wholesale finance provided the incentive and the ability for them to transform. By fueling growth, wholesale funding enabled MSPs to learn by doing. The more their improved internal systems enabled them to grow safely, the more funding they attracted in a virtuous circle.

97. There are many proven approaches to enable MSPs to access funding. Many countries use a combination of models rather than only one: (i) public fund, (ii) government-owned bank, (iii) specialist nonbank credit institution, (iv) guarantees to encourage private banks to lend, (v) directed credit (regulatory mandates for private bank lending), and (v) regulatory environment for MIV wholesaling

B. Approaches to Enable Microfinance Service Providers

1. Model 1: Public Fund

98. Public funds were a common tool for wholesale lending starting in the late 1990s and many were started with funding from international development agencies. However, because of problems regarding their legal status, government involvement, and lack of professionalism, much less funding is available for them today.

99. Among the countries that have coursed wholesale funds through public funds are (i) Bangladesh: Palli Karma-Sahayak Foundation (PKSF), (ii) Kazakhstan: Damu Entrepreneurship Development Fund, (iii) Egypt: Social Fund for Development, and (iv) Pakistan: Poverty Alleviation Fund (PPAF).

a. Case Study: Palli Karma-Sahayak Foundation of Bangladesh

100. The origins of Bangladesh's microfinance sector date back to the early 1970s, but its growth began to accelerate in the mid-1980s. To support the sector, in 1990 the Government of Bangladesh set up Palli Karma-Sahayak (Rural Employment Support) Foundation (PKSF) to provide wholesale funds to microfinance institutions, most of which were not banks and, therefore, could not finance their loan portfolios from deposits. Although it was originally funded by the government, PKSF was established as an independent organization outside government bureaucracy. This enabled it to form its own policies and develop its own management practices suitable for its activities.

101. Since it started in 1990, PKSF has made a total of more than $3 billion in wholesale loans. As of June 2018, it had an outstanding portfolio of $590 million lent to 277 partner MFIs. PKSF loans fueled the growth of many MFIs in the 1990s, including two of the four leading institutions, the Association for Social Advancement (ASA) and BRAC. Over the years, it received grant funds from the Government of Bangladesh, the World Bank, the United States Agency for International Development, ADB, IFAD, Department for International Development (DFID) of the United Kingdom, and the Kuwait Fund for Development. Today, however, grants finance less than a quarter of PKSF's loan portfolio. Most of the portfolio is financed out of earnings retained over the organization's many years of operations. The portfolio is large enough that interest income is sufficient to cover the cost of operations, including reserves and financing costs.

102. In addition to financing, PKSF also coordinates the delivery of institutional development capacity-building support to its partner organizations. Focused on strengthening financial sustainability and outreach, PKSF's institutional development activities include research, workshops, seminars, and on-site technical assistance as well as a special loan product.

103. The biggest challenge PKSF faces is that it is not able to mobilize commercial funds. It has not been successful in borrowing from banks and MIVs. This is mainly because of its legal status as a nonprofit company and the fact that the government is the only shareholder.

104. Viet Nam's only experience to date with a dedicated microfinance wholesale facility used a model similar to PKSF: The Credit Support Fund (CSF) (Box 2).

Box 2: Credit Support Fund in Viet Nam

The Credit Support Fund (CSF) was one of the outcomes of the project Strengthening of the Institutional Capacity of the Viet Nam Women's Union (VWU) to Manage Savings and Credit Programs for Rural Poor Women, also known as the Viet Nam-Belgium Credit Project, a 15-year program implemented by the VWU starting in December 1997 that aimed at providing credit and savings access to rural poor women in 17 provinces of Viet Nam.

After the project closed in December 2012, VWU sought to continue CSF's operations. A wholesale lending model is not specifically covered in the Credit Institutions Law of 2010, but special permission was granted by the Government of Viet Nam through Official Letter Number 3238/VPCP–KHTH dated 24 April 2013 and the Official Letter Number 1700/VPCP–KHTH dated 14 March 2014, which allowed it to continue making wholesale loans as a pilot project until 31 December 2014. After an evaluation conducted by the State Bank of Vietnam, the pilot was extended until 31 December 2016 under Official Letter No. 3015/VPCP–KTTH signed by Deputy Prime Minister Vu Van Ninh on 27 April 2015.

Between 2012 and September 2016, CSF continued to operate successfully, achieving an average of 5% RoA and RoE. During this period, CSF financed both licensed MFIs as well as unlicensed microfinance organizations, demonstrating that Vietnamese microfinance service providers, even those that are small and unregulated, are creditworthy. CSF also continued to deliver capacity-building/technical assistance along with wholesale financing to partner microfinance service providers (MSPs). This capacity-building support contributed to MSPs' ability to effectively and efficiently provided access to microfinance for the poor and near poor.

However, CSF also had several inherent weaknesses. VWU staff assigned to CSF did not have a background in finance. They were trained and capable, but they were severely understaffed. Since VWU senior management also do not have a background in finance or business in general, they were unable to provide a commercial orientation or a long-term vision and strategy for the organization. Being housed within the VWU gave the perception that CSF was biased in its choice of partner MSPs.

continued on next page

Box 2 continued

CSF's greatest weakness, however, was its shaky legal status. With no regulatory space for this kind of financial institution in the Credit Institutions Law of 2010, CSF owed its existence to the Prime Minister's decisions, which were time-bound. This made CSF unattractive to banks and microfinance investment vehicles. Indeed, their caution proved prescient: CSF was not granted a third permission to continue and was closed.

Source: ACCESS Advisory. Viet Nam: Consultation on Evaluating and Building a Development Strategy for Credit Support Fund–Viet Nam Women's Union in phase 2017–2022. Unpublished.

2. Model 2: Government-Owned Development Bank

105. Many countries have a government-owned development bank with a microfinance wholesale department. Government-owned development banks are funded by a combination of state funds and commercial or semicommercial loans from international development agencies.

106. Among the countries that have coursed wholesale funds through a state-owned bank are (i) India: Small Industries Development Bank (SIDBI), (ii) Mexico: Nacional Financiera, (iii) Colombia: Bancoldex, (iv) Ecuador: Corporación Financiera Nacional, and (v) the Philippines: LandBank.

a. Case Study: Small Industries Development Bank of India

107. The SIDBI was established by the Indian Parliament in 1990, and offers products and services in areas including loans, trade finance, and fixed deposits to entrepreneurs and small businesses. It is also a channel for various government subsidies to small businesses.

108. The SIDBI participates in the Indian microfinance sector by providing credit and capacity-building grants to medium- and large-scale microfinance institutions. It does this through the SIDBI Foundation for Microcredit (SFMC), which was set up with assistance from IFAD and DFID and began operations in January 1999. In addition to providing loans, equity, and grants to MFIs, the SFMC's mission includes (i) capacity-building support, (ii) development of a network of service providers and advocacy for policy and regulations, and (iii) promotion of the exchange of information across the sector.

109. During its first phase (1999–2005), the SFMC provided almost all of the funding to the sector. It also managed a comprehensive package of support to partner MFIs based on annual capacity building needs assessments that were funded by DFID and IFAD. In doing so, it helped start a generation of MFIs across India. Many of its early partners became the leading institutions in the country.

110. Because of those long-term relationships, the majority of SFMC's funding is currently lent to larger MFIs. However, it also has a portfolio of smaller, early stage partners and sees part of its role as expanding the frontiers of microfinance by taking more risk than commercial banks. For these early-stage MFIs, the SFMC also provides time-bound grants to finance training and technical assistance, fixed assets, and operating deficits.

111. Although it provides this support, the SFMC actively encourages its partners to mature to the point that they can access commercial funding. It has been very successful: SFMC's share of debt funding for the sector as a whole declined from nearly 100% of lending in its initial years to just 10% by early 2010 as the larger and more profitable MFIs gained access to commercial bank loans. Today, the SFMC has a policy of providing no more than 15%–20% of larger MFIs' funding needs. To facilitate commercial funding, it has created a Lender's Forum, with over 40 domestic banks. It

shares information on MFI performance with these banks, including its own credit ratings. Further, it structures some of its own finance to fill critical gaps in equity and subordinated quasi-equity loans, which facilitates bank lending to the MFI.[43]

112. After a series of documented abuses by MSPs and of suicides of MSP clients in the Indian state of Andhra Pradesh in 2010, the SFMC began emphasizing the importance of responsible finance. It now requires all partner MFIs to implement a code of conduct that lays out a set of core values for microfinance, including ethical behavior, avoidance of over-indebtedness, transparency, and promotion of financial literacy. This commitment has been written into SIDBI's loan agreements, which require all MFIs to undergo an independent assessment of adherence to its Code of Conduct as well as other measures to ensure transparency and ethical behavior.

3. Model 3: Nonbank Financial Institution

113. Nonbank credit institutions that specialize in making uncollateralized wholesale loans to MFIs have been created in many countries. They often receive equity as well as debt financing from international development agencies. They can be incorporated as investment companies as well as banks.

114. Among the countries that have coursed wholesale funds through a specialist nonbank are (i) Pakistan: Pakistan Microfinance Investment Company (PMIC), (ii) Nepal: RMDC Laghubitta Bittiya Sanstha Ltd., and (iii) the Philippines: People's Credit and Finance Corporation.

a. Case Study: Pakistan Microfinance Investment Company

115. Wholesale finance for Pakistan's microfinance sector was originally provided by the Pakistan Poverty Alleviation Fund (PPAF). The PPAF had been established by the government as a public company limited by guarantee in 1984 to address problems related to health, education, and rural development. In 2000, as the country's microfinance sector began to develop, the PPAF added a Financial Institutions Unit and received funding from the World Bank to onlend to MFIs.

116. After the State Bank of Pakistan (SBP) created a licensing system that allowed MFIs to convert into microfinance banks and mobilize deposits, the PPAF's wholesale operations were central to the growth of the sector. By 2013, PPAF had provided $90 million in loans, one-third of all financing of the sector. Even this figure understates the importance of the PPAF's wholesale facility: it financed all or most of the portfolios of 34 of Pakistan's 43 microfinance institutions and banks.

117. The growing size, complexity, and risk of microfinance wholesale operations meant that it could not remain as a specialized unit within the PPAF. The PPAF's board was composed of government officials, academics, and charity workers who did not have a background in finance. The PPAF's legal status made it an unattractive partner for banks and other investors. As such, a decision was made in 2013 to spin off PPAF's microfinance wholesale operations into a stand-alone entity.

118. The PMIC was launched in 2016 as a nonbank finance company registered with the Securities and Exchange Commission. The PPAF provided 49% of the start-up equity, with the remainder coming from a Pakistani nonprofit company that promotes access to finance for small businesses (38%) and German development cooperation through KfW (13%). As of 2018, the PMIC had a portfolio of $148 million

[43] F. Sarah et al. 2012. *A New Look at Microfinance Apexes.*

outstanding to 21 microfinance banks and institutions. In addition to its equity, the PMIC's portfolio is financed by subordinated loans from its main shareholders as well as $12.5 million (PRs2 billion) in loans from banks. The cost of the subordinated loans is 6% and the bank loans are priced at 50 basis points over 6-month bank rates (roughly 3%). For the year that ended on 31 December 2018, the PMIC earned revenues of $10.6 million (PRs1.7 billion), a return on equity of 4.55%.

119. The PMIC's role as a sector developer goes beyond wholesale finance. Its "Microfinance Plus" products and services include research, capacity building, support for new product development, and creating strategic partnerships between microfinance institutions and other service providers (especially digital platforms) to better meet the needs of the end users.

120. Finally, the PMIC also plays the role of a sector enabler. Along with the Pakistan Microfinance Network (the industry association), the PMIC represents the sector on various committees at the national level, especially with the regulator and industry bodies, and continues to ensure that the interests of the sector are protected at the field and provincial government level.

4. Model 4: Government-Sponsored Credit Guarantees

121. Several countries have sought to use guarantee schemes to encourage banks to lend to MFIs. Guarantors usually cover at most 70% of the loan. Often, the remainder is covered through other means, such as a promissory note signed by the legal representatives of the borrowing MFI.

122. Among the countries that have used credit guarantees to encourage private banks to lend are (i) Colombia: National Guarantee Fund. (ii) Pakistan: Microfinance Credit Guarantee Facility, and (iii) Morocco: Caisse Centrale de Garantie.

a. Case Studies: Colombia, Pakistan, and Morocco

123. In Colombia, a significant amount of wholesale funding for microfinance comes from BANCÓLDEX, originally Banco de Comercio Exterior. Its Microenterprise Banking Department, which is under the Commercial Banking Division, runs its Entidades Orientadas al Crédito Microempresarial program. As of the end of 2018, this program had lent $227 million (₱880 billion) to 79 MFIs.

124. BANCÓLDEX requires borrowing MFIs to be profitable and also apply to the National Guarantee Fund for a guarantee worth at least 50% of the loan (70% is preferred). The remainder of the loan needs to be backed by an endorsement of 130% A-rated promissory note signed by the legal representatives of the borrowing MFI. Its loan portfolio is financed by a combination of deposits, bonds, and loans from multilateral development agencies such as the Inter-American Development Bank and Andean Development Corporation.

125. In Pakistan, the SBP has used multiple credit guarantee schemes (for agriculture and MSMEs) over the years. Its Microfinance Credit Guarantee Facility was established in 2008 with £15 million from DFID. Originally, it guaranteed 40% of loans issued by banks to microfinance banks and institutions (MFBs/MFIs), but in 2015 it increased the guarantee's coverage to 60% to support smaller and weaker institutions.

126. The scheme had some success: 21 banks and DFIs accessed guarantees valued at $11.6 million, making 61 loans totaling $137 million to 12 microfinance banks and institutions. Nevertheless, it did not achieve its mission of using the guarantees as a demonstration tool to give banks the confidence to lend

to MFBs and/or MFIs without a guarantee. When the Pakistan Microfinance Investment Company was established in 2016, the SBP ended the guarantee scheme.

127. In Morocco, which has some of the highest rates of financial inclusion in the Middle East/North Africa region, the Caisse Centrale de Garantie (Central Guarantee Agency [CCG]) has played an important supporting role. Its 2009–2012 development plan introduced new guarantee products for loans to SMEs. Different guarantee schemes were made available for investment loans, working capital loans, restructured loans, and minimum returns on equity investments. Eligibility requirements were eased, fees reduced, and administrative processes streamlined.

128. Since 2012, the CCG has been supported under the World Bank's Morocco Micro, Small, and Medium-Sized Enterprises Development Project, which provided $50 million to support the CCG's partial credit guarantee program for micro, small, and medium-sized enterprises (MSMEs) loans, including its new Damane Express product for very small enterprises, and "Ilyaki", a guarantee product for loans of up to $1,000 (MAD100,000 [Moroccan Dirham]) to businesses led by women. In addition to financial support, the World Bank aims to strengthen the capacity and sustainability of the country's leading guarantee scheme through the provision of technical assistance in the areas of risk management and product development, as part of the regional MSME technical assistance facility, in close collaboration with the IFC.

5. Model 5: Directed Credit (Regulatory Mandates for Private Bank Lending to Microfinance Institutions)

129. Directed credit programs, which mandate that a minimum portion of bank loans must be allocated for specific objectives, have been adopted by many countries as a tool to channel financial resources towards economically and politically important sectors of the economy that are otherwise underserved. Although they differ significantly by country in terms of size, scope, strategy, and focus, the primary objective is to provide credit support so that economic growth is inclusive. Traditionally, the priority sectors in most countries include agriculture (Brazil, Pakistan, India, the Philippines) and small-scale industry (Japan, the Republic of Korea, India, the Philippines), both of which employ a large number of people, are geographically spread across the entire nation, and occupy small-sized owners. More recently, sectors like renewable energy or businesses owned by women have been included in priority sectors.

130. Currently, no country mandates that banks direct credit specifically to the microfinance sector. However, India and Nepal allow banks to make loans to MFIs (or intermediary wholesale institutions that lend to MFIs) as a way of complying with directed credit mandates for small-scale businesses.[44]

A. Case Study: India

131. The Reserve Bank of India (RBI) mandates that all banks must allocate 40% of their assets to priority sectors, of which 7.5% must be allocated for microenterprises. Banks have opted to lend to microfinance institutions to achieve their mandated targets.

[44] The SBP and Bangladesh Bank take a different approach by negotiating with banks to set a target amount (rather than a percentage of assets) of credit to priority sectors. However, in neither case have banks made substantial wholesale loans to MFIs as a way of achieving this target. In Sri Lanka, the central bank announced that it would introduce PSL targets for the micro, small, and medium-sized enterprises in January 2021. The bank's Monetary Board had approved the policy and discussions with the banking community regarding the lending targets are ongoing.

132. The Microfinance Institutions Network reported that total microfinance loans as of September 2019 was ₹2.3 trillion (D730 trillion or $31 billion) to 57 million unique clients. Total priority sector lending (PSL) to the microfinance sector (excluding self-help groups) was ₹160 billion (D50 trillion or $2 billion). Private banks provided 57% of this funding to 333 MFIs and MFOs. Public sector banks provided 36% of total wholesale funds to 914 MFIs and MFOs.

133. RBI's rules for qualifying microfinance wholesale loans as priority sector loans are detailed. Retail loans by borrowing MFIs must meet the following criteria;[45]

(i) The loan is extended to a borrower whose household annual income in rural areas does not exceed ₹125,000 (D40 million or $1,700) while for nonrural areas it should not exceed ₹200,000 (D63 million or $2,750).
(ii) The loan does not exceed ₹75,000 (D24 million or $1,030) in the first cycle and ₹125,000 in subsequent cycles.
(iii) Total indebtedness of the borrower (excluding education and medical expenses and debt) does not exceed ₹125,000.
(iv) The loan term is less than 24 months and repayable in weekly, fortnightly, or monthly installments, with no penalty for prepayment.
(v) The loan is made without collateral.
(vi) The loan complies with the margin cap (10% for MFIs with a total loan portfolio above ₹1 billion (D310 billion or $14 million) and 12% for others. The processing fee is not included in the margin cap or the interest cap.

134. To be able to report this information to RBI, banks must obtain from MFIs at the end of each quarter a chartered accountant's certificate stating that the criteria on (i) qualifying assets; (ii) the aggregate amount of loan, extended for income generation activity; and (iii) pricing guidelines have been followed.

6. Model 6: Regulatory Environment for Private Sector Wholesaling

135. There are 121 MIVs with nearly $17 billion under management in 94 countries. MIVs provide 43% of debt funding in local currency, although the rates are usually higher than in United States dollar (8%–10%). They also conduct an extensive due diligence to ensure the borrowing MFI is bankable.

136. The countries that are the largest recipients of MIV funding are[46] India (12.4%), Cambodia (6.9%), Ecuador (6.7%), Georgia (5.6%), Peru (4.1%), and Mexico (3.2%)

a. Case Study: Cambodia

137. The initial funding of Cambodia's leading microfinance institutions came from international development agencies, either directly to microfinance projects or indirectly via sponsoring NGOs. This was at a time, in the early and mid-1990s, that donors placed a very high priority on microfinance, and funding was readily available. However, as they began to grow, it was soon recognized that the need for microfinance services in Cambodia was far beyond what donor agencies could finance.

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[45] Reserve Bank of India. 2021. *Master Directions – Priority Sector Lending (PSL)–Targets and Classification*.
[46] Symbiotics. 2019. *MIV Survey Market Data & Peer Group Analysis*.

138. The first attempt at providing wholesale funds was through the creation of a government bank. The Rural Development Bank was established in 1998, but after several years of operations, it issued only $1 million in loans. Its capacity to assess and monitor MFIs was weak, its loan requirements too restrictive, and its processes too slow. Few MFIs applied for their loans. Today, the Rural Development Bank has a portfolio of $180 million lent mostly to rice millers.

139. With the failure of a government bank to serve as a wholesale finance institution, a new mechanism was needed. The antecedent for this new approach occurred when ACLEDA NGO, the largest MFI in the country, announced its intention to transform into a bank. It already had enough retained earnings to meet the minimum capital requirement ($15 million at the time). However, knowing that it needed technical support to improve its internal operations and credibility to seek new financing in the future, ACLEDA asked four international development agencies to invest equity into the new bank and sit on the board of directors.

140. None of the other microfinance projects or NGOs was large enough to become a bank, but at the end of 1999, the National Bank of Cambodia created a framework for NGOs to transform into licensed microfinance institutions. Licensing meant that MFIs would be supervised by the central bank just like commercial banks. Licensing also changed the nature of the sector, transforming the MFIs from projects and NGOs into self-sustaining businesses, albeit businesses with a social mission. By 2005, the 10 largest NGOs had become licensed MFIs.

141. It was around this time that a major shift in funding for MFIs took place around the world. As the microfinance model became mature, adapted with success to various contexts, international development agencies no longer felt the need to provide grants or subsidized funding to them. This funding was replaced by "social investors"—sometimes from the commercial arm of development agencies (such as the World Bank's International Finance Corporation) but mostly from private sector MIVs.

142. The MIVs' leading role in the development of microfinance in Cambodia was not limited to financing. Even if they were lenders rather than equity investors, they often had a seat on the board of directors of the MFIs they financed. As with ACLEDA Bank, the MFIs saw their role on the board as providers of both expertise and credibility with other lenders and investors. As of 2018, even as the ownership of the major MFIs has shifted to Asian commercial banks, MIVs still finance about $800 million (8%) of the entire sector.

V. APPLYING WHOLESALE LENDING MODELS TO THE VIETNAMESE CONTEXT AND POLICY RECOMMENDATIONS

143. Because of its unique context, none of the wholesale finance models described in section IV can be applied immediately in Viet Nam. Each will require legal, regulatory, and institutional reforms to be viable. A detailed analysis of the legal, regulatory, operational, and capacity challenges to each model is provided in Appendix 4.

A. Applying Wholesale Lending Models to the Vietnamese Context

1. Model 1: Public Fund

144. Given that Viet Nam has prior experience with the CSF, reestablishing a public fund to manage wholesale loans to MFIs and MFOs might appear to be the easiest course of action. Creating a new fund would have to overcome the government's policy of fiscal consolidation and a reduction of off-budget items, which includes consolidating and reducing the number of public funds. However, an exception to this policy can be justified given the strategic role that microfinance could play in achieving the targets in the NFIS and the socioeconomic impact discussed in Appendix 6. Mobilizing an existing public fund to manage wholesale loans to the sector does not appear to be practical.[47]

145. However, other factors should be taken into consideration before pursuing this option. The first issue is organizational capacity. When it closed, CSF had only 15 outstanding loans to eight MFIs and MFOs totaling D35 billion ($1.5 million). It had a limited staff with sufficient capacity to manage such a small portfolio, but otherwise its organizational structure was highly informal, with no clear departments and staff covering multiple (often unrelated) functions. Governance, risk management, and the information system were weak.[48]

146. If a new public fund will manage a wholesale portfolio that is 10 or 100 times larger than CSF, it will require a much larger number of staff and stronger internal systems that will take years to build. The former staff of CSF could be recruited, but since they are organic to the VWU, they would have to resign their positions in the VWU in order to join. As noted in Box 1, the fact that CSF was housed within the VWU contributed to its organizational weakness in a number of ways. If a new public fund is created, it should be independent of any single sociopolitical organization, both to guard against potential conflicts of interest and to have sufficient autonomy to recruit staff.

147. Another key constraint facing the public fund option is funding. As noted in section IV, public funds were a leading method for providing wholesale funds to MFIs in the late 1990s—back when the sector was characterized mainly by NGOs and the evidence that the microfinance model was commercially viable was not yet clear. In the intervening years, the microfinance sector professionalized, but public funds did not, partly because of their legal status and partly because of the role of the public sector in managing them. International development agencies and MIVs are much less likely to lend to public funds than they were in the past.

148. A public fund would not necessarily require funding from international development agencies or MIVs, however. It could be financed domestically through the state budget or directed credit from banks. Regarding the former, the main challenge is that it subjects the microfinance sector to the budgetary approval process. This is far from guaranteed. Regarding the latter, directed lending creates other problems that are discussed starting in paragraph 159 below.

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[47] The SME Development Fund is governed by the SME Support Law and Decree 39/2019/ND–CP which specifies that the businesses receiving funding must be registered. Unregistered household businesses run by microfinance clients do not qualify for funding. Other existing public funds, such as the Support Fund for Farmers and the Cooperative Assistance Fund would require even more legal and operational changes to be mobilized for microfinance wholesale lending.

[48] ACCESS Advisory. Viet Nam: Consultation on Evaluating and Building a Development Strategy for Credit Support Fund–Viet Nam Women's Union in Phase 2017–2022. Unpublished.

2. Model 2: Government-Owned Banks

149. Viet Nam has a number of policy banks and state-owned commercial banks that could be mobilized to provide wholesale funds to MFIs and MFOs. The VBSP might appear to be an obvious choice. It already serves poor and low-income clients, and its liabilities are legally eligible for a government guarantee. However, there are several challenges in mobilizing the VBSP for this purpose: (i) it serves the same clients as MSPs, which creates a conflict of interest that puts the VBSP into direct competition with them; (ii) as a policy bank, its corporate governance, regulatory, and accounting frameworks are less developed than other financial institutions; (iii) wholesale lending is an entirely new business line for which VBSP would need significant capacity building before it could enter prudently; and (iv) the government would need to amend Decree 78/2002/ND-CP governing VBSP's operations to allow it to lend to MSPs. Viet Nam's other policy bank, the Viet Nam Development Bank, would face these same issues but does not have VBSP's experience of working with low-income clients.

150. Another option is Agribank, which also lends to poor and low-income clients. Based on Decree 55/2015/ND-CP on the credit policy for agricultural and rural development and amended by Decree 116/2018/ND-CP, all credit institutions, including Agribank, are allowed to provide uncollateralized loans of up to D100 million to individuals and households outside of rural areas engaged in agricultural production and business activities and up to D200 million to those in rural areas.[49] Although these decrees specify uncollateralized loans, the borrower is required to submit a land use rights certificate or a commune-level people's committee's written certification that they have not yet been granted a land use rights certificate and that the land is dispute-free.[50]

151. Agribank serves other types of clients and areas outside the scope of these decrees. For example, it provides consumer credit to fight usurious black credit, but this program is currently only aimed at people in rural areas, remote and isolated areas, and economically difficult areas. Agribank is also allowed to lend to intermediates such as cooperatives or cooperative unions. This expertise could be mobilized to provide wholesale loans to MSPs as long as Agribank can manage the potential conflict between its mandate and lending to MSPs with an urban as well as rural clientele.

152. A third option is Co-Op Bank. Its experience providing financial intermediation functions to PCFs shows it has the capacity to make wholesale loans to grassroots financial institutions. Moreover, in meetings conducted for this assignment, Co-Op Bank expressed an interest in providing such loans to MFIs and MFOs. To do so, it will need to update its charter and articles of incorporation. The framework for credit institutions would also need to be updated, especially rules for interlending between credit institutions and collateral requirements. Co-Op Bank appears to have sufficient liquidity to provide wholesale funds from its own balance sheet without external funds, but would need technical support to build and manage a wholesale loan portfolio prudently.

3. Model 3: Nonbank Financial Institution

153. The Credit Institutions Law (CIL) of 2010 does not provide for any type of wholesale lending. Lending between credit institutions is limited to short-term liquidity loans. Therefore, legal changes are needed to create space for a new credit institution that specializes in lending to MFIs and MFOs as was done in Pakistan or Nepal.

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49 Decree 55/2015/ND–CP, Article 9.2(a)(b); and Decree 116/2018/ND–CP, Article 1.3 (a)(b).
50 Decree 55/2015/ND–CP, Article 9.3, 9 June 2015.

154. Some international examples suggest that such a nonbank financial institution could be established as a subsidiary of an existing financial institution. This approach allows the parent to provide immediate support to the subsidiary in terms of expertise and systems, encourages specialization, and allows for a segregated balance sheet.

155. However, creating a subsidiary for lending to MSPs faces two challenges in Viet Nam. First, the CIL would need to be amended. Article 103 of the CIL allows banks to establish subsidiaries only to conduct activities such as securities brokerage, financial leasing, and insurance. Second, commercial banks consulted for this assignment do not believe that the market for wholesale loans is large or profitable enough to warrant creating a subsidiary.

4. Model 4: Government-Sponsored Credit Guarantees

156. There is no national-level organization or fund in Viet Nam providing guarantees on loans. Further, the Law on Public Debt Management of 2017 places stringent limits on loans that qualify for a government guarantee, and no longer allows credit institutions to qualify for government guarantees at all.

157. There are existing provincial public funds providing guarantees that are used to support loans to SMEs. However, since these funds are governed by the SME Support Law, they are only allowed to issue guarantees to registered businesses. MSPs are excluded because they would onlend the funds to farms, household enterprises, and other unregistered businesses.

158. It is legally feasible to develop a private sector-led guarantee scheme. Circular 07/2015/TT–NHNN allows commercial banks, cooperative banks, and finance companies (except specialized finance companies) to provide loan guarantees.[51] However, the key problem is that commercial banks consulted for this assignment are uncomfortable with MFIs' credit risk and would require a counter-guarantee from a third party. The refusal of banks to take any risk makes this option unattractive.

5. Model 5: Directed Credit (Regulatory Mandates for Private Bank Lending to Multilateral Financing Institutions)

159. Although directed credit can create a new funding source for MSPs, the experience in India and elsewhere show that it has several important drawbacks:

(i) It creates a moral hazard. With beneficiaries easily able to access credit, it reduces healthy pressures for them to professionalize.
(ii) Directed lending imposes an implicit tax on banks that reduces the economic efficiency of a key sector. This cost would be better born through normal budgetary procedures and funded through the government's general fiscal resources.
(iii) Banks will inevitably prioritize lending to the largest and most commercialized institutions, which would leave a funding gap for the other MSPs.
(iv) Mandating banks to move down-market creates a credit risk of MSPs' defaulting.
(v) Compliance creates a regulatory burden for the banks, which would be responsible for monitoring and reporting on their directed lending.

[51] Circular 07/2015/TT–NHNN on bank guarantee, Article 2, 25 June 2015.

160. Further, effectively using the directed credit model requires much more than a regulatory mandate. In general, a directed credit model for microfinance requires a complete ecosystem to be effective. Banks need to make significant adjustments to their due diligence and underwriting requirements to be able to lend without collateral or to an entity that is not legally an enterprise (such as an MFO or MFP). Loan loss provisioning and write-off regulations would need to be adjusted to take into account the higher potential risk of lending without collateral. Finally, MSPs need to be capable of absorbing the loans.

6. Model 6: Regulatory Environment for Private Sector Wholesaling

161. International MIVs are already active in Viet Nam. Their wholesale lending is restricted because the legal and regulatory environment limits the number of MFIs that are able and willing to borrow from them. Regulatory reforms that increased the number of licensed MFIs and create space for licensed nondeposit taking MFIs would contribute to the development of more "bankable" MFIs that would enable MIVs to become more active in Viet Nam.

162. However, MIV funding is not always appropriate for all MFIs and is generally not available to unlicensed MFOs and MFPs because of their uncertain legal status, weak capacity, and small size.

B. Recommendations

163. As discussed in section I, the sector's lack of funds for onlending is more a symptom than a cause of poor performance. Funders see the sector lacking professional management, growth prospects, and transparency. Even if more wholesale funds had been available over the past decade, growth may not have been much faster because the sector, as currently, constituted is not capable of strong growth and has unused liquidity.

164. As such, it is recommended that the Government of Viet Nam take an approach that develops a more robust microfinance sector, with a variety of institutional types, professional management, and sufficient access to wholesale funds. A holistic approach that can support growth has multiple elements:

1. Recommendation 1: Encourage new investment by removing restrictions on ownership

165. The NGO-oriented MFIs and MFOs run by sociopolitical organizations should be retained, but the imminent revision of the CIL and regulations for microfinance creates an opportunity to open the sector, giving existing institutions the option to orient their businesses toward growth and allowing new institutions to enter.

166. The regulatory mandate that all MSPs must be controlled by a sociopolitical organization is the single greatest factor limiting the growth of the sector. The dominant role of the controlling organizations has a direct negative impact on the ability of MSPs to attract funding.

167. The perception that MSP leaders are from social organizations and that microfinance is a nonprofit "social activity" rather than a business is widespread across all industry stakeholders and outside observers. From the government to MSP staff and the clients, almost everyone perceives microfinance in social terms. This perception is also held by banks, contributing to their reluctance to provide wholesale loans. International MIVs actively encourage MSPs to pursue a social mission, but still expect them to be commercially oriented.

168. Another limiting factor is simply financial: since the organizations that own or control MSPs are not commercial, they have limited resources of their own. They do not have the capital to increase an MSP's equity, and they do not have the assets necessary to collateralize a loan. The inability of the sponsoring organizations to backstop MSPs makes lenders cautious. This is true for Vietnamese banks as well as international MIVs.

169. The mandate that sociopolitical organizations and social funds must control an MSP is not the only regulatory factor that sustains the NGO mindset in the sector. The limit of five members of a multiple-member limited liability company[52] shuts out new investors, forcing MFIs to rely on their original incorporators for additional equity as well as managerial support. The qualifications for managers are set in such a way that the sponsoring political or sociopolitical organizations to promote their own members to leadership positions. The prevalence of internally promoted leaders with limited qualifications hampers both the professionalization of management and the flow of new ideas into MSPs.

170. An overview of the regulatory requirements for ownership and management that limit MSP growth is provided in Table 8.

Table 8: Regulatory Requirements for Ownership and Management that Limit Microfinance Service Provider Growth

Issue	Circular 03/2018 (MFIs)	Decision 20/2017 (MFOs/MFPs)	Impact on Growth
Ownership/ incorporators	Article 8 requires that at least one founding member being a political or sociopolitical organization. Article 29 requires that no other members to hold equity larger than that of political or sociopolitical organizations.	Article 4 limits incorporators of MFOs and MFPs to political organizations, political organizations, and nongovernment organizations (both international and domestic).	The political or sociopolitical organizations that are allowed to establish and control MSPs typically do not have a background in business or finance. They do not have the human or financial resources that MSPs need in order to grow. Because of these factors, political or sociopolitical organizations are unattractive partners for lenders and investors in microfinance.
Foreign ownership	Article 8 stipulates that the only foreign organizations allowed to be founding members of an MFI are foreign banks. Article 29 requires that foreign banks' equity must not be larger than that of political or sociopolitical organizations.	Not applicable	Foreign banks are extremely hesitant to invest in an MFI in which they are in a minority position, especially vis-à-vis a political or sociopolitical organization. Further, foreign banks rarely specialize in microfinance. International microfinance specialist organizations are usually incorporated as nonbank financial institutions, microfinance institutions, or nongovernment organizations.

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[52] Circular 03/2018, Article 17(2). MFI incorporators are termed "members" rather than investors.

Table 8 continued

Issue	Circular 03/2018 (MFIs)	Decision 20/2017 (MFOs/MFPs)	Impact on Growth
Qualifications of managers	Article 22 states that the director general of an MFI must have a bachelor's degree in economics, finance, accounting, auditing, banking, business administration, or law and at least 2 years' experience as executives of credit institutions or at least 2 years' experience as director general (director) of enterprise with owner's equity at least equal to legal capital of an MFI as per the law or at least 3 years' experience as managerial post in microfinance sector or at least 5 years of experience as employees in finance, banking, accounting, or auditing sector.	Article 4.2(c) stipulates that the manager of a MFO or MFP must have a bachelor's degree in economics, banking, finance, accounting or business management, or higher decree, or has at least 1 years' experience in banking operations or microfinance operations.	The minimum qualifications are low and enable the sponsoring political or sociopolitical organizations to promote their own members to leadership positions. The prevalence of internally promoted leaders with limited qualifications hampers both the professionalization of management and the flow of new ideas into MSPs.

MFI = microfinance institutions, MFO = microfinance organization, MFP = microfinance program, MSP = microfinance service provider.

Source: Circular 03/2018/TT–NHNN, Decision 20/2017/QD–TTg, and author's analysis.

171. The current rules on MSP ownership have had additional unintended effects. MoM Tien Giang has the third largest number of clients and fourth largest portfolio, but it does not qualify for an MFI license because a foreign NGO, Norwegian Mission Alliance, owns the majority of shares. In another case, the Fund for Poor Women in Ha Noi meets the requirements for licensing set out in Decision 20 but cannot apply because it is owned by the central VWU, which also owns TYM MFI, and the law does not allow sociopolitical organizations to own two MFIs.[53] This means that two very large organizations are left operating outside the supervision of the SBV.

2. Recommendation 2: Create a new regulatory category of licensed credit-only microfinance institutions

172. As noted in section I, a large number of sizable MSPs are currently operating outside SBV supervision. This is because the requirements to obtain a license are so high that medium-sized MFOs and MFPs are unable, and sometimes unwilling, to meet them. Since MFIs are allowed to mobilize deposits from the general public, it makes sense to set the requirements high enough to ensure the safety of those deposits. However, the unintended consequence is that many MSPs see no pathway to formalization.

173. The fact that so many MSPs still have the legal personality of a social fund contributes to the sector's NGO mindset. It enables them to continue operating with weak accounting systems, underdeveloped business plans, and finances that are not transparent. It effectively prevents them from qualifying for a loan from a bank or MIV.

174. No other major market allows so many medium-sized institutions to operate outside the regulatory framework. The way almost all of the leading markets have addressed this gap in the regulatory framework is by creating a category of licensed credit-only MFIs. Since they pose less of a risk to the

[53] Circular 03/2018/TT–NHNN, Article 8(1)(c) and Article 8(2)(c)(iii), 23 February 2018.

finance sector, the licensing requirements for credit-only MFIs can be set low enough for many of the larger MFOs and MFPs to qualify.

175. However, this recommendation is not simply geared toward strengthening the prudential regulation of the microfinance sector. A tiered regulatory framework facilitates the sector's development by creating a clear and achievable pathway for transformation. Each step up the ladder is also a step up in terms of organizational development, and the greater business opportunities that become available as an MSP moves up the ladder provide the incentive to upgrade.

176. Relatedly, the CIL should be revised to explicitly allow banks to provide long-term wholesale loans to both classes of licensed MFIs. This will provide an incentive for MFOs and MFPs to seek a license (especially if a nondeposit taking MFI license is available) and encourage licensed MFIs to seek a credit rating, which is helpful to unlock bank funding.

3. Recommendation 3: Remove restrictions on client acquisition that slow growth and discourage investors

177. There are other aspects of the regulatory framework that impede growth. The most important is the low maximum loan size of just D50 million ($2,200). This cap reinforces the perception in the minds of leaders as well as clients that microfinance is only for the poorest households, not a tool for the entrepreneurial poor to use for their farms and businesses. In addition, limits on geographic expansion constrain MSPs to small markets. Only four unlicensed MSPs operate in two provinces or cities; the vast majority operate in just one (Table 9).

Table 9: Regulatory Requirements that Limit Microfinance Service Provider Client Acquisition

Issue	Circular 03/2018 (MFIs)	Decision 20/2017 (MFOs/MFPs)	Impact on Growth
Loan size	Article 32 limits the size of a microfinance loan to D50 million ($2,200).	Article 13 limits the size of a microfinance loan to D50 million ($2,200).	Limiting loan sizes or deposits forces MFI/MFOs to "refuse" serving their target clients who need larger loans. Further, this limit reinforces the perception that microfinance is for the very poorest, not a tool for the entrepreneurial poor to use for their farms and businesses. Even if a loan size cap is desired, the current level is too low. The equivalent in the Philippines is $3,000 (D70 million) and in Myanmar it is $4,000 (D93 million).
Geographic expansion	Article 34 requires an MFI to follow SBV regulations[a] in expanding operation beyond the province in which it is headquartered.	Article 12 places restrictions on the ability of an MFO/MFP to expand beyond the area specified in its registration certificate.	Restrictions on the geographical area of operations and/or requiring complex procedures to add branches limit the ability of MFIs to achieve economies of scale.

MFI = microfinance institution, MFO = microfinance organization, MFP = microfinance program, SBV = State Bank of Vietnam.

[a] Circular 19/2019/TT–NHNN on operating networks of microfinance institutions, 5 November 2019.

Source: Circular 03/2018/TT–NHNN, Decision 20/2017/QD–TTg, and author's analysis.

178. In addition to slowing growth, these restrictions discourage investment because investors largely rely on growth to drive their returns. A detailed analysis of the legal and regulatory barriers growth and development of microfinance service providers is provided in Appendix 5.

4. Recommendation 4: Support Co-Op Bank to provide wholesale loans from its own balance sheet without state funding

179. The demonstration effect of successful lending to MSPs could come from DFIs or MIVs. However, MIV funding is neither appropriate nor available for all MFIs and MFOs. Smaller organizations will not be able to qualify for commercial funding, much less absorb it. An alternative domestic wholesale model is required.

180. Rather than recreating CSF from scratch, with all of the capacity development needs it will have, it is recommended that Co-Op Bank be mobilized for this purpose. Co-Op Bank faces the least legal and operational challenges compared to other banks. It has expressed an interest in wholesale lending, has relevant experience, and has the liquidity to enter this market. It will need significant technical support to make uncollateralized loans to MFIs and MFOs, but development partners would likely be willing to support such capacity development. Further, the demonstration effect from a domestic institution like Co-Op Bank lending to MSPs will encourage banks to enter the market.

APPENDIX 1: LIST OF MICROFINANCE SERVICE PROVIDERS RANKED BY NUMBER OF BORROWERS AS OF DECEMBER 2019 (OR LATEST AVAILABLE DATA)

No.	Name	Clients	Loans ($)
1	CEP MFI	339,468	190,979,500
2	TYM MFI	104,357	62,993,793
3	MoM Tien Giang	41,084	13,134,427
4	Fund for the farmers	30,313	1,204,914
5	Thanh Hoa MFI	20,329	15,301,872
6	Fund to support women in economic development	17,439	4,872,340
7	Ha Tinh Women and Development Fund	17,428	6,411,060
8	CWED HCM City	13,652	2,005,478
9	MF program for women PWU	13,619	9,171,319
10	World Vision – MFU	12,937	5,186,929
11	MF project Ha Noi WU	12,040	4,584,132
12	Fund for the poor (VWU)	12,040	4,683,787
13	Fund for poor women	11,500	928,147
14	Capital aid fund for youth union members	11,064	492,888
15	Support fund of labor federation	10,000	553,147
16	Fund to support women development	9,156	2,083,000
17	Fund for poor workers	8,635	3,006,078
18	M7 MFI	8,089	5,479,243
19	Capital aid fund for poor workers	8,000	508,966
20	Revolving fund for women PWU	7,527	1,465,435
21	Dong Thap fund to support poor women	5,938	853,174
22	Building and repairing household hygienic construction revolving fund	5,892	984,652
23	SEDA	5,683	2,739,267
24	Fund to support women development Bac Kan	5,126	3,235,522
25	ACE	4,923	1,349,440
26	Fund for women in Thai Binh Province	4,587	1,063,549
27	DWAF	4,552	476,853
28	MFSD	4,175	992,759
29	Fund to support women development Ninh Thuan District	3,976	775,435
30	CMF (CFRC)	3,477	1,323,922
31	Fund to support women development Gai Lan	3,262	976,783
32	Fund to support women development Ninh Phuoc District	3,250	507,716
33	Water supply and household hygienic revolving fund	3,138	1,023,261
34	Fund for women Dong Trieu District	3,062	301,164
35	Fund for the farmers	2,725	1,062,848
36	VietED Foundation	2,689	1,670,246

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Appendix 1 continued

No.	Name	Clients	Loans ($)
37	Tay Ninh Fund to support poor women	2,665	522,130
38	PPC	2,410	1,358,966
39	Fund to support women in economic development	2,224	272,069
40	Fund to support women development	2,196	519,435
41	Fund to support women development	2,170	661,271
42	CWED Hai Phong City	2,121	1,614,348
43	Microfinance Project Quang Yen District	2,037	53,405
44	Fund to support women development Dien Bien Phu City	1,716	856,897
45	CWCD	1,700	410,690
46	Fund to support women development Dien Bien District	1,550	620,905
47	Fund to support women development HaGiang Province	1,547	663,739
48	Fund to support women development Da Nang	1,507	511,050
49	Fund to support women' business	1,000	1,582,609
50	Savings and credit program of women in Phu Yen District	909	3,803,922
51	Aquaculture project - Provincial WU	810	35,302
52	An Phu MF Program	766	306,336
53	SEEDS	750	541,250
54	Dzambala Foundation	568	216,897
55	Savings and Credit Project of women in Thuan Chau District	540	52,974
56	My Duc Microfinance Project (M&D)	465	169,655
57	Support together for community Bach Thong District	450	178,491
58	H4H	446	63,405
59	Savings and credit fund Na Ri District	377	229,267
60	VAC Project - Provincial WU	341	15,776
61	Poor Women Project – PWU	165	7,586
62	Malaria Project – PWU	153	6,897
63	Hanoi Labor Federation	n.a.	1,549,138
64	MF project Tra Linh District	n.a.	104,224
65	Fund to support women development Cao Bang Province	n.a.	294,871
66	Credit fund forestry collaboration program Viet Nam-Finland	n.a.	62,888
67	Credit revolving fund-forestry collaboration program Viet Nam – Finland	n.a.	167,543
68	Center for community development	n.a.	241,509
69	Fund to support women development provincial WU	n.a.	172,629
70	MF project Cao Phong District	n.a.	275,474
71	MF project Ky Son District	n.a.	190,086
72	Capital aid fund for poor workers - LF Thai Nguyen Province	n.a.	1,035,690
73	Poverty reduction project (Misereor's donation)	n.a.	19,397
74	Revolving fund for household hygienic construction	n.a.	32,931
75	Savings fund for the poor women	n.a.	3,448
76	Village development project Thai Nguyen Province	n.a.	29,310
77	Fund to support women in economic development	n.a.	129
78	Capital aid fund for workers	n.a.	517

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Appendix 1 continued

No.	Name	Clients	Loans ($)
79	Capital to support start-up business women	n.a.	99,310
80	Fund to support women in economic development	n.a.	49,741
81	Revolving fund for household hygienic construction	n.a.	885,129
82	New starting fund	n.a.	104,397
83	Fund to support women development PWU	n.a.	591,435
84	Fund for women in economic development in Quang Tri Province	n.a.	44,655
85	Hearts for Hue	n.a.	133,060
86	Capital aid fund for poor workers	n.a.	504,310
87	Supporting fund Labor Federation	n.a.	496,509
88	Development fund in Son Nguyen commune	n.a.	34,009
89	PWU	n.a.	24,784
90	Provincial labor federation	n.a.	70,474
91	Program to support women in poverty reduction	n.a.	292,414
92	Savings and credit project in Binh Dai District	n.a.	332,457
93	Supporting fund for poor women, women with disabled child, and disabled women	n.a.	6,466
94	CEP	n.a.	3,303,578
95	Fund for poor women	n.a.	5,345
96	Dariu foundation	n.a.	1,783,276
97	Fund to support women in economic development	n.a.	237,974
98	Capital aid fund for poor workers	n.a.	383,621
99	Fund for poor women	n.a.	1,019,267
100	CESVI and DAVED programs	n.a.	650,783
Total		806,715	384,591,092
	Licensed MFIs	472,243	274,754,408
	Licensed MFIs % total	59%	71%
	Unlicensed MSPs	334,472	109,836,684
	Unlicensed MSPs, % total	41%	29%
	Of which, unregistered MSPs	63,167	20,247,307
	Unregistered MSPs, % total	8%	5%

n.a. = not applicable.

Sources: Data compiled from reports by State Bank of Vietnam, Viet Nam Women's Union, and Viet Nam Microfinance Working Group.

APPENDIX 2: COMPARISON OF LEGAL AND REGULATORY REQUIREMENTS IN VIET NAM VERSUS COUNTRIES HIGHLY RANKED FOR THEIR GOVERNMENT AND POLICY SUPPORT

	Viet Nam	Colombia	Mexico	Rwanda	Tanzania	Peru
2019 Economist Intelligence Unit Microscope ranking for government and policy support for financial inclusion	32	1	2	3	4	5
Maximum loan size	D50 million ($2,200)	None	None	None	None	None
Interest rate cap	Yes, maximum rates on loans of up to 1 year in term are set by the State Bank of Vietnam periodically	1.5 times the current average banking sector rate	None	None	None	None
Microfinance banks	Banks can lend to microfinance borrowers, but there are no specific regulations for banks that specialize in microfinance.	Regulations allow for banks that specialize in microfinance. The minimum capital is $32.7 million.	Regulations allow for small banks offering limited services. The minimum capital is $11.7 million.	Regulations allow for banks that specialize in microfinance. Minimum capital for commercial banks is $5.5 million, for development banks million 3.3 million.	Regulations allow for banks that specialize in microfinance. Minimum capital for microfinance banks is $2 million.	Regulations allow for banks that specialize in microfinance. Minimum capital is $8.2 million.
Deposit-taking nonbank microfinance service providers	Allowed. Minimum asset D75 billion[a] ($3.3 million).	Not allowed except for cooperatives	Allowed. Sociedades Financieras Populares (SOFIPO), nonbank cooperatives that can take deposits and offer loans, have a minimum capital requirement of $32,500.	Allowed. Deposit-taking multilateral financial institutions (MFIs) have a minimum capital requirement of $1.6 million.	Not allowed except for cooperatives	Allowed. Minimum capital for urban Caja Municipal de Ahorro y Credito (CMAC) is $4.1 million, and for Caja Rural de Ahorro y Credito (CRAC) it is $373,000.
Nondeposit taking nonbank microfinance service providers	Not allowed	Not allowed	Unregulated Sociedades Financieras de Objeto Multiple (SOFOMES)—nonbanks that cannot take deposits, but can make loans, leasing and factoring operations. Minimum capital is $812,500.	Allowed but all nondeposit taking microfinance institutions (MFIs) have converted to deposit-taking MFIs.	Allowed. Minimum capital is $8,700.	Regulations allow for licensed Entidades de Desarollo para la Pequena y Microempresa (EDPYME) that provide loans to micro, small, and medium-sized enterprises. The minimum capital is $373,000.

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	Viet Nam	Colombia	Mexico	Rwanda	Tanzania	Peru
Nongovernment organization microfinance service providers	Social funds, microfinance organizations, and programs are the main nongovernment providers of microfinance services	Allowed	Allowed	Allowed. Nongovernment organization-MFIs are considered informal. They do not have a license, but are required to register with their local government.	Allowed	Allowed
Operational restrictions or mandates	Microfinance service providers are restricted in their area of operations.	None	None	None	The central bank has issued guidelines that instruct banks to open branches where they are not currently located. The directive is to encourage banks to become more accessible to the furthest corners of the country, instead of serving only large towns and cities.	None
Foreign ownership	Only foreign bank allowed to be founding members and must keep ratio not larger than that of Vietnamese social and social-political organizations	No restrictions on foreign owners of banks	No restrictions on foreign owners of banks	No restrictions on foreign owners of banks	No restrictions on foreign owners of banks	No restrictions on foreign owners of banks
Borrowing from abroad	Allowed for licensed MFIs	Allowed	Allowed	Allowed	Allowed	Allowed

[a] Decision 20/2017/QD–TTg, Article 15, 2 June 2017.

Source: 2019 Economist Intelligence Unit Microscope Ranking for government and policy support for financial inclusion.

APPENDIX 3: COMPARISON OF LEGAL AND REGULATORY REQUIREMENTS IN VIET NAM VERSUS ASIAN COUNTRIES WITH LARGE MICROFINANCE INDUSTRIES

	Viet Nam	India	Philippines	Thailand	Cambodia	Myanmar
2019 Economist Intelligence Unit Microscope on ranking for government and policy support for financial inclusion	32	8	10	23	27	35
Maximum loan size	D50 million ($2,200)[a]	Total debt of customers cannot exceed $1,750	$3,000	None	None	$4,000
Interest rate cap	Yes, maximum rates on loans of up to 1 year in term are set by SBV[b] periodically	2.75 times the average base rate of five large commercial banks (2.75 * 8.2% = 22.5% as of September 2020)	None	28%	18% per year (fees are not included in the calculation)	2.5% per month (30% per year)
Microfinance banks	Banks can lend to microfinance borrowers, but there are no specific regulations for banks that specialize in microfinance.	Regulations allow for small finance banks that serve low- and middle-income populations. The minimum capital is $14 million.	Some rural banks offer microfinance services. Those with a head office outside Metro Manila have a minimum capital requirement of $104,000 to 1 million depending on the geographic area. The minimum capital for cooperative banks is $209,000.	There are no specific regulations for banks that specialize in microfinance. Banks are encouraged to downscale but focus on SMEs rather microenterprises with no collateral.	Several MFIs have converted to banks and remain highly focused on microfinance. The minimum capital for a bank is $75 million.	There are no specific regulations for banks that specialize in microfinance.
Deposit-taking nonbank microfinance service providers	Allowed. Minimum asset D75 billion ($3.3 million)[c]	Not allowed except for cooperatives	Not allowed except for cooperatives	Not allowed except for cooperatives	Allowed. Minimum capital is $30 million.	Allowed. Minimum capital is $24,000.

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	Viet Nam	India	Philippines	Thailand	Cambodia	Myanmar
Nondeposit taking nonbank microfinance service providers	Not allowed	Allowed. Minimum capital is $720,000.	Not allowed	Allowed, but minimum capital of $1.6 million is too high for MFIs in this market.	Allowed. Minimum capital is $1.5 million.	Allowed. Minimum capital is $12,000.
Nongovernment organization (NGO) microfinance service providers	Social funds, microfinance organizations and programs are the main nongovernment providers of microfinance services	Allowed	NGO microfinance institutions (MFIs) account for a large part of the sector. Minimum capital is $3,100	Allowed but requirements make NGOs non-viable.	Allowed. They are required to register with the central bank. They must be licensed if they have more than 1.000 clients or $250,000 in loans.	Allowed
Operational restrictions or mandates	Microfinance service providers are restricted in their area of operations and face certain difficulties expanding to new districts or provinces.	Small finance banks are required to place 75% of their credit with "priority sector borrowers and open at least 25% of their branches in rural unbanked areas. Nonbank MFIs can only lend to clients whose household income does not exceed $1,760 in rural areas and $2,800 in urban areas.	At least 50% of the bank's gross loan portfolio should consist of microfinance loans. Microfinance NGOs are required to loan at least 70% of their funds to their intended beneficiaries.	None.	None	At least 50% of clients must be from a rural area; no loans are allowed for luxury goods; and a loan cannot be provided to more than one member of the household.
Foreign ownership	Only foreign bank allowed and must keep ratio not larger than that of Vietnamese social and social-political organizations	Foreigners can own up to 74% of a bank. 100% foreign ownership is allowed for nonbank MFIs	Not allowed for banks only	Not allowed	Allowed	Allowed

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	Viet Nam	India	Philippines	Thailand	Cambodia	Myanmar
Borrowing from abroad	Allowed for licensed MFIs	Allowed	Allowed for all types of microfinance service providers	Not applicable since there are no providers who seek international funding	Allowed	Locally owned MFIs can only borrow from the Myanmar Economic Bank. Foreign-owned MFIs can only borrow from foreign lenders and no single loan can exceed $3 million. Foreign MFIs need Central Bank of Myanmar approval for all loans.

[a] Circular 03/2018/TT–NHNN, Article 32.5, and Decision 20/2017/QD–TTg, Article 13.2(c)

[b] For (i) loans taken out to support the agricultural and rural development sector under regulations of the government on credit policies for agricultural and urban development; (ii) loans taken out to implement the export business plan in accordance with the Law on Commerce and other instructional directives thereof; (iii) loans taken out to finance business activities of small and medium-sized enterprises under the government's regulations on support for development of small and medium-sized enterprises; (iv) loans taken out to develop ancillary industries under the government's regulations on the development of ancillary industries; (v) loans taken out to finance business operations of high technology application enterprises under the provisions of the Law on High Technology and other instructional directives thereof; as regulated in Circular 39/2016/TT–NHNN dated 30 December 2016 on lending transactions of credit institutions and/or foreign bank branches with customers.

[c] Decision 20/2017/QD–TTg, Article 15, 2 June 2017.

Source: 2019 Economist Intelligence Unit Microscope Ranking for government and policy support for financial inclusion.

APPENDIX 4: SUMMARY OF LEGAL, REGULATORY, OPERATIONAL, AND CAPACITY CHALLENGES TO WHOLESALE MODELS IN VIET NAM

Strategy	Required Legal and Regulatory Challenges	Operational and Capacity Challenges
1. Public fund	• Creating a public fund that specializes in wholesale lending to microfinance service providers is legally feasible.a However, since public funds are off-budget items, their establishment conflicts with current government policy to consolidate and reduce the number of public funds.b Creating a new one is politically difficult. • The SME Development Fund, which was originally established under the supervision of the Ministry of Planning and Investment by a Prime Minister's Decision 601/QD–TTg in 2013 and is now governed by the SME Support Law and Decree 39/2019/ND–CP, cannot be mobilized for microfinance because the SME Support Law specifies that the businesses receiving funding must be registered.c Unregistered household businesses run by microfinance clients do not qualify for funding. • Other existing public funds, such as the Support Fund for Farmers (established by Prime Minister's Paper No. 4035/KTTH in 1995) and the Cooperative Assistance Fund (established by Prime Minister's Decision No. 246/2006/QD–TTg in 2006) would require even more legal and operational changes to be mobilized for microfinance wholesale lending.	• Secure legal status is a prerequisite for any fund to be able to obtain funding from public or private sector sources. The Credit Support Fund could not access funding because its legal status was uncertain. • A fund will need technical support to learn how to make loans to microfinance institutions (MFIs) with limited collateral, whose assets (loans) are also not collateralized, and whose prudential requirements are looser than those for mainstream banks.
2. Government-owned bank 2.1 Lending via the Viet Nam Bank for Social Policies (VBSP	• As a policy bank, VBSP can only participate in the MFIs wholesale lending if the government assigns this task to VBSP and revises related regulations, charter, and mechanisms to allow VBSP to implement. • In addition, rules that limit wholesale lending in the Credit Institutions Law as well as other regulations such as Decree 78/2002/CPd will have to be amended.	• VBSP's development strategy for the period of 2021–2030 does not stipulate that VBSP will lend to microfinance institutions and, therefore, would need to be amended. • Since VBSP's main mandate targets retail clients who are poor and near-poor, if VBSP were to enter into wholesale lending, it recommends that the MFIs that receive wholesale loans should target a different market segment: above-poverty clients. This would be in line with SBV's policy to eliminate "black lending" which targets most of the above-poverty groups. • To make wholesale loans, VBSP will need assistance to launch an effective wholesale lending operation. In particular, it will need technical support to learn how to make loans to MFIs with limited collateral, whose assets (loans) are also not collateralized, and whose prudential requirements are looser than those for mainstream banks. This support will include technical assistance for developing a strategic approach, operational risk analysis and management, portfolio management and delinquency control.

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Strategy	Required Legal and Regulatory Challenges	Operational and Capacity Challenges
		• Although VBSP has prior experience relevant to microfinance wholesale lending, it recommends that, in the short term, ADB should consider choosing a commercial bank to provide wholesale loans.
2. Government-owned bank 2.2. Lending via Agribank	• Decree 55/2015/NĐ–CP on the credit policy for agricultural and rural development and amended by Decree 116/2018/ND–CP allow Agribank to provide uncollateralized loans to borrowers in rural areas or engaged in agri-business, however, uncollateralized loans must be backed by land title.	• To make wholesale loans, Agribank will need assistance to launch an effective wholesale lending operation. In particular, it will need technical support to learn how to make loans to MFIs with limited collateral, whose assets (loans) are also not collateralized, and whose prudential requirements are looser than that for mainstream banks. This support will include technical assistance for developing a strategic approach, operational risk analysis and management, portfolio management and delinquency control.
2. Government-owned bank 2.3 Lending via Co-Op Bank	• To provide wholesale loans to MFIs, Co-Op Bank will need to update its charter/articles of incorporation. • The framework for credit institutions needs to be updated, especially rules for interlending between credit institutions and collateral requirements.	• Co-Op Bank's past support for People Credit Funds shows it has the capacity to make wholesale loans to grassroots financial institutions. • To make wholesale loans, Co-Op Bank will need assistance to launch an effective wholesale lending operation. In particular, it will need technical support to learn how to make loans to MFIs with limited collateral, whose assets (loans) are also not collateralized, and whose prudential requirements are looser than that for mainstream banks. This support will include technical assistance for developing a strategic approach, operational risk analysis and management, portfolio management, and delinquency control.
3. Nonbank credit institution	• The Credit Institutions Law (CIL) of 2010 in general does not clearly provide for microfinance wholesale lending. Because of the lack of provisions in the law, it is not legally feasible to create a new credit institution that specializes in lending to microfinance service providers as was done in Pakistan. • Further, the CIL does not allow credit institutions to establish a subsidiary to make such loans. Article 103 of the CIL allows banks to establish subsidiaries only to conduct some certain activities such as securities brokerage, financial leasing, and insurance.	• Commercial banks consulted for this assignment do not believe that the market for wholesale loans is large or profitable enough to warrant creating a subsidiary, even if it were legally possible.
4. Government-sponsored credit guarantees	• There are existing provincial public funds providing guarantees that are used to support loans to small and medium-sized enterprises (SMEs). They were established starting in 2001 by Prime Minister's Decision No.193/2001/QD–TTg and then amended by another Prime Minister's Decision in 2013 (58/2013/QD–TTg). Currently, they are governed by Decree 34/2018/ND–CP,e which requires that guarantees be backed either by property, a credit rating, or a feasible business plan. These funds are only allowed to issue guarantees to registered businesses as defined in the SME Support Law. Microfinance service provides do not qualify for a guarantee.	• Commercial banks consulted for this assignment said that they would be unwilling to lend unless there is a 100% guarantee. Donor agencies or social impact funds would be willing to provide first loss financing, but this kind of "partial wrap" typically guarantees 30%–50% of the loan size (e.g., it is a partial guarantee). The refusal of banks to take any risk makes this option unattractive to potential funders.

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Strategy	Required Legal and Regulatory Challenges	Operational and Capacity Challenges
	• At the national level, there is no fund providing loan guarantees. Further, the Law on Public Debt Management of 2017 places stringent limits on loans that qualify for a government guarantee, and no longer allows credit institutions to qualify for government guarantees at all. The only exception, described in Article 4 of Decree 91/2018 regarding government guarantee issuance and management, is that credit programs of policy banks that are regulated by the Law on Public Investment are eligible for a government guarantee. If, for example, microfinance was added to the government's policy credit programs via VBSP, those loans might be eligible for a government guarantee. • It is feasible to develop a private sector-led guarantee scheme. Circular 07/2015/TT–NHNN allows[f] commercial banks, cooperative banks, and finance companies (except specialized finance companies) to provide loan guarantees.	
5. Directed credit	• There is no provision for mandates in the CIL or relevant regulation. • Article 3. State Bank of Vietnam Circular No. 39/2016/TT–NHNN[g] explicitly states that "a credit institution shall have autonomy over its lending operations and assume sole responsibility for its own lending decision. None of entities or individuals shall be allowed to illegally interfere in lending operations performed by a credit institution". • Article 15 (1 and 2) of Circular 39/2016/TT-NHNN stipulates that "1. The credit institution and its customer shall agree on whether or not a loan security is applied. Agreement on loan security between the credit institution and its customer must conform to regulations on loan security and relevant legislation. 2. The credit institution shall make its decision on and bear responsibility for any unsecured loan.	• If the State Bank of Vietnam changes the laws and regulations and mandates such lending, banks would need to change their due diligence and underwriting requirements to be able to lend without collateral or to an entity that is not legally an enterprise such as an microfinance organization. • Compliance requirements create a regulatory burden for the banks, which would be responsible for monitoring and reporting on their directed lending.
6. Private-sector lending via international microfinance investment vehicles (MIVs)	• International MIVs are already active in Viet Nam. However, their wholesale lending is restricted because the legal and regulatory environment limits the number of MFIs that are able and willing to borrow from them. • Regulatory reforms that would contribute to the development of more "bankable" MFIs will enable MIVs to become more active in Viet Nam.	• On the demand side, the main constraint for MIV funding is its cost, including the cost of the foreign exchange rate risk. • MIV funding is not available for unlicensed microfinance organizations and microfinance programs.

[a] The Law on State Budget, Article 4.19; and Decree 163/2016/ND–CP guiding the Law on State Budget, Article 12.
[b] Resolution 792/NQ–UBTVQH14 of the NA on consolidating regulation on management and usage of off-budget public financial funds.
[c] The SME Support Law, Article 2; Decree 39/2019/ND–CP on *SME Development Fund,* Article 16, 10 May 2019.
[d] Decree 78/2002/ND–CP on *Credit for poor people and other policy beneficiaries*, 4 October 2002.
[e] Decree 34/2018/ND–CP *on the establishment, organization and operations of credit guarantee funds for SMEs*, Article 25, 8 March 2018
[f] Circular 07/2015/TT–NHNN on *bank guarantees*, Article 2.
[g] Circular 39/2016/TT–NHNN on prescribing on lending transactions between credit institutions and foreign bank branches with clients, 30 December 2016.

Source: Author's analysis using the laws and regulations listed in a-g above.

APPENDIX 5: LEGAL AND REGULATORY BARRIERS TO GROWTH AND DEVELOPMENT OF MICROFINANCE SERVICE PROVIDERS

Issue	Source Document	Legal or Regulatory Requirement	Impact on Growth	Recommendation
Ownership	Circular 03/2018/TT–NHNN On Licensing, Organization and Operation of Microfinance Institutions	Article 8. Controlling owners and founding member of microfinance institutions (MFIs) 1. A controlling owner of an MFI which is incorporated in the form of single-member limited liability companies must meet the following conditions: (i) It is a political organization or sociopolitical organization incorporated and lawfully operating in Viet Nam or a political organization, sociopolitical organization, association, social fund, charitable fund that has microfinance program/project transformed as prescribed in a Decision of the Prime Minister on operation of microfinance programs/projects of political organizations, sociopolitical organizations, or non-governmental organizations; 2. A founding member of an MFI which is incorporated in the form of multiple-member limited liability companies must meet the following conditions: (i) There is at least a founding member being political organization or sociopolitical organization; (ii) There is at least a founding member which has directly run or managed a microfinance program/project safely and steadily for at least 3 consecutive years before the application submission;	The institutions that are allowed to establish microfinance institutions do not have a background in business or finance. They cannot adequately provide the leadership or the financial support that MSPs need to grow to the next level. Further, because of their lack of relevant experience and capacity, these organizations are unattractive partners for lenders and investors in microfinance.	To encourage new leaders and new ideas in the sector, make the requirement that socio-political organizations, social organizations, socioprofessional organizations of Viet Nam, charity funds, social funds, and nongovernment organizations be optional rather than mandatory. The goal should be to encourage a wide variety of providers. Evidence from other countries demonstrates that in commercialized microfinance markets, although some providers target less-poor customers, others continue to focus on the poor. Mission drift is therefore MSP-specific rather than a sector-wide phenomenon. Article 120(2) of the Credit Institution Law already provides the State Bank of Vietnam with a tool to minimize mission drift: "Microfinance institutions shall maintain a ratio between total outstanding credits to low-income individuals and households, super micro enterprises and total outstanding credit of microfinance institutions not to be lower than a ratio stipulated by the State Bank."

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Issue	Source Document	Legal or Regulatory Requirement	Impact on Growth	Recommendation
		Article 29: Proportion of capital holding 1. The proportion of capital holding of all contributing members being political organizations and socio-political organizations must be at least 25% of the charter capital of the MFI. 2. The proportion of capital holding of domestic contributing members other than political organizations or sociopolitical organizations may not exceed the shareholding of political organizations or sociopolitical organizations.		Concerns that more commercially minded providers will drift away from their mission to serve the poor can be further addressed through non-prudential requirements such as mandatory annual social performance and client protection audits and reports.
		3. The proportion of capital holding of foreign contributing members may not exceed the shareholding of political organizations or sociopolitical organizations.	This requirement of operating 3 years before being qualified to apply for a license effectively prevents any new operation from being launched in Viet Nam. No experienced microfinance company would agree to wait 3 years to obtain a license.	Many MSPs have operated for longer than 3 years and have shown limited capacity development. The length of operations is not an accurate indicator for successful operations. Instead, the key metrics for gauging an applicant for an MFI license should be based on the following: The prior experience of all sponsoring organizations in microfinance, whether in Viet Nam or outside The qualifications and experience of the management team The quality of the business plan
Definition of target clients	Circular 03/2018/TT–NHNN On Licensing, Organization and Operation of Microfinance Institutions	Article 3. Interpretation of terms “microfinance client” means an individual living in a poor household, near poor household, an individual representing a poor household, near poor household, or microenterprise as per the law.	Although there is some flexibility in these definitions, in general the microfinance sector sees itself as existing to serve “the poor”, which often means targeting the same customers being served by VBSP. This definition reinforces the perception that microfinance is a social activity that is not much different than a charity or nongovernment organization. It also limits the target client base of the MSPs, preventing them from reaching scale.	Define microfinance clients as any economically active adult that is underbanked. This will broaden the potential client base of MSPs and prevent them from focusing only on the very poor who are already served by VBSP. Include a separate article in Decree No. 93/2019/ND–CP dated 15 November 2019specifically governing social funds providing microfinance services, and write it to encourage professionalization rather than the charity mindset.
	PM Decision No. 20/2017/ QD–TTg Regulations on Activities of Microfinance Programs and Projects of Political Organizations, Sociopolitical Organizations and Non-Governmental Organizations	Article 3. Definitions A microfinance client means an individual who is a member of a poor household, near-poor household, household escaping poverty or household having average living standards; an individual having low income or a microenterprise.		

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Issue	Source Document	Legal or Regulatory Requirement	Impact on Growth	Recommendation
Loan size limits	Circular 03/2018/TT–NHNN On Licensing, Organization and Operation of Microfinance Institutions	Article 32. Operations The total outstanding loans of an MFI for a microfinance client must not exceed D50 million. Total outstanding loans of an MFI to another client must not exceed D100 million.	The limit of D50 million for a microfinance loan size replaces the limit of D30 million stipulated in Circular No. 07/2009/ TT–NHNN. However, it is still too restrictive. This is especially true in rural areas because of the seasonal nature of farming. From the perspective of clients, the low limit means that microfinance loans have limited usefulness, leading some to feel that MSP services are not responsive to their needs. From the point of view of MSP managers, this limit reinforces the perception that microfinance is only useful for the very poorest, not a tool for the entrepreneurial poor to use for their farms and businesses.	Remove the limit on the size of loans or at least raise it to a level that can be useful to under-banked farmers and business owners. Best practice would be to remove the limit altogether, as is the case in leading microfinance countries such as Colombia, Mexico, Rwanda, Tanzania, and Peru. If a cap is to be retained, the ceiling should not be based on international comparisons but instead on the domestic context. The cap should be based on the financial needs of those customers and their other sources of supply. A key benchmark is provided by Article 3(b) of Decree 116/2018/ ND–CP, which sets the maximum allowable uncollateralized loan size for individuals and households in rural areas at D200 million. Many MSP clients, as well as the majority of the unbanked population in Viet Nam, are also farmers or rural entrepreneurs. There is no reason why they should be subject to loan sizes that are one-quarter of this cap. In many countries, MSPs also serve SMEs that cannot meet the collateral and other requirements for a bank loan. SMEs in Viet Nam also have this problem. If it is envisioned that the microfinance sector will also serve this segment, then a maximum loan size of up to D500 million or $20,000 would be appropriate.
	PM Decision No. 20/2017/ QD–TTg Regulations on Activities of Microfinance Programs and Projects of Political Organizations, Sociopolitical Organizations and Non-Governmental Organizations	Article 13. Activities of a microfinance program The maximum loan size of a microfinance client does not exceed D50 million.		

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Issue	Source Document	Legal or Regulatory Requirement	Impact on Growth	Recommendation
Geographic expansion	Circular No. 19/2019/TT–NHNN Operating Networks of Microfinance Institutions	Article 7. Operating areas and names of branches and transaction offices A branch of the MFI operates within the province or central-affiliated city where it is located.	Restrictions on the geographical area of operations and/or requiring complex procedures in order to add branches limit the ability of MFIs to expand financial inclusion. Article 20, Clause 1 of the Credit Institutions Law does not make this a requirement for commercial banks when applying for a license.	Licenses should automatically allow MFIs to operate nationwide. Conditions for expansion of their operational network should be based on principles applicable to credit institutions while still simple and suitable to the specific features of MFIs.
Limits on products and operations	Credit Institutions Law	Article 120. Provision of credit of microfinance institutions Microfinance institutions shall be allowed to provide credit in VND in the forms of loans. The provision of credit by microfinance institutions might be secured by compulsory savings or guarantees of a group of savings and borrowing customers.	These articles provide some flexibility by using the words "might" or "can" rather than "must". Nevertheless, most MSP lending methodologies are secured with compulsory deposits and/or a group guarantee. Many underbanked clients do not wish to join solidarity groups or make compulsory deposits. They may have different types of collateral to pledge (such as land title). These articles prevent MSPs from serving them.	Laws and regulations should not specify the lending methodology. Acceptable collateral should include assets other than compulsory deposits. Concerns about MSPs foreclosing on assets can be addressed in regulations governing collection and liquidation.
	Circular No. 03/2018/TT–NHNN On Licensing, Organization and Operation of Microfinance Institutions	Article 32 An MFI may only provide loans in dong to microfinance clients and other clients to earn income and improve living conditions. Loans granted by an MFI can be secured by compulsory savings, guaranteed by the group of depositors and borrowing customers in accordance with regulations of the MFI.		
	PM Decision No. 20/2017/QD–TTg Regulations on Activities of Microfinance Programs and Projects of Political Organizations, Sociopolitical Organizations and Nongovernment Organizations	Article 13. Activities of a microfinance program 2(b) Conditions for lending: A loan of a microfinance client is guaranteed by compulsory savings and/or a group of microfinance client.		

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Issue	Source Document	Legal or Regulatory Requirement	Impact on Growth	Recommendation
	Credit Institutions Law Payment services	Article 121. Opening accounts of microfinance institutions Microfinance institutions shall not be allowed to open payment accounts for their customers.	Although Article 122 of the Credit Institutions Law allows licensed MFIs "to provide collection, payment orders, and remittance services to microfinance customers", this provision makes remittance services unattractive to customers.	Licensed MFIs should be able to offer domestic payment services. This will require them to participate in the domestic interbank payments system.
	Credit Institutions Law Participation in payment systems	Article 102. Organization of and participation in payment systems A commercial bank may organize its internal payment system and participate in the national interbank payment system	The inability to participate in the interbank system limits the ability of MSPs to offer services and manage their liquidity.	Allow licensed MFIs to participate in the domestic interbank payments system, subject to prudential regulations.

APPENDIX 6: SOCIOECONOMIC IMPACT OF MICROFINANCE IN VIET NAM

Since the 1980s, microfinance has been promoted as a way to contribute to poverty alleviation. The earliest experiments with modern microfinance in Bangladesh, Bolivia, and elsewhere explicitly tied their loans to investment in income-generating farms and microenterprises. Microfinance gained worldwide popularity because, unlike the poverty alleviation programs and projects of development agencies and nongovernment organizations, it could continue providing services indefinitely because of its financial sustainability.

Although the pioneering practitioners linked microfinance to increased income, the theorists were much more cautious. They noted that there is a fundamental difference between a loan in cash and other productive assets such as land, seeds, and fertilizer. Those assets could only be used for one purpose; fertilizer, for example, is not a substitute for food. But money borrowed to purchase fertilizer could be used to pay for food—and actually is used that way if there is not enough income or savings that day to put food on the table. If income earned tomorrow is used to buy fertilizer, did the loan pay for the food or the fertilizer?

This phenomenon is the "fungibility" of money. A loan is mixed in with the client's other sources of money and used for both consumption and investment as needs arise. In this view, a loan is only an enabler. It may make it possible for clients to increase their income, but the outcome is because of their business decisions, not the loan. Indeed, recent research on women microfinance clients in Viet Nam and the Philippines locates the key success factor in the mindset of the entrepreneur.[1]

Nevertheless, the belief that microfinance loans are made primarily to help clients increase their income persists. Profiles of clients who started or expanded a successful business are regular features in the industry's promotional material. Even if business acumen rather than credit is the key success factor, it is believed that a sizeable portion of microfinance clients have it. A recent survey of Asia's largest network of microfinance service providers (MSPs), the Banking with the Poor Network (BWTP), found that nearly 75% of respondents agreed or strongly agreed with the statement "Gaining access to financial services has a direct impact on income."[2]

Statistical evidence does not support this claim. In one of the most prominent examples, the results of randomized evaluations of microfinance clients conducted in six countries on four continents in both urban and rural areas found only modestly positive, but not transformative, effects on income because of access to credit.[3] Access to formal financial services was correlated with an increase in business profits, but that was mostly because it reduced borrowing costs. It hardly led to any growth in revenues, business inputs, or the number of jobs generated.

Certainly, some microfinance clients do succeed in increasing their income, but the ratio is low enough to conclude that access to finance itself is not the main contributing factor. In light of convincing

1 S. Taylor. 2020. *Successful women microentrepreneurs - the transition to security*. Foundation for Development Cooperation, Kenmore QLD, Australia.

2 BWTP's work consists of exploring, demonstrating, and publicizing the scope for increased access to and use of financial services for the poor on a sound commercial basis. http://bwtp.org/resources/microfinance-impact-survey-a-call-to-rebalance-industry-priorities.

3 B. Abhijit et al. 2019. *Six Randomized Evaluations of Microcredit: Introduction and Further Steps*. American Economic Journal: Applied Economics 2015, 7(1): 1–21, Nashville, TN, USA.

evidence that usage of loans and other financial services is not correlated with increases in income, the microfinance industry has reevaluated its role. In October 2019, CGAP offered a new "impact narrative for financial inclusion" that identifies two sets of potential outcomes for low-income households after they gain access to financial services.[4] The first is "resilience"—the ability to afford life's necessities even when income is irregular or when illness, natural disasters, or other shocks occur. The second is "capturing opportunities that improve their well-being", including everything from education to home improvement, medical services, access to electricity, water, and sanitation, and even migration. "Investing in a business" is mentioned as one way to capture opportunity, but no longer is it the main, or even one of the central, reasons for promoting microfinance or financial inclusion.

This new framework for understanding the socioeconomic impact of microfinance is much closer to the view of the original theorists. Microfinance loans increase client's purchasing power, and that enables them to better manage their economic lives. "Resilience" acknowledges that microfinance loans are used for consumption purposes when income or savings are insufficient. "Capturing opportunities" recognizes that microfinance loans are used for goods and services that improve "well-being" without necessarily increasing income.

The fact of the matter is that low-income households have always borrowed for these reasons. Since their income is not only low but also unpredictable, they borrow as often to cover basic expenses and pay school fees and utility bills as much as they borrow to purchase inventory for their shop or fertilizer for their farm. If they only have access to informal and semiformal sources (family, rotating savings and credit associations, moneylenders, pawnshops), their ability to be resilient and capture opportunities is constricted. One of the rationales for creating MSPs was to offer clients better financial service than their traditional sources.

Since CGAP's framework is new, no studies that use it to measure impact have been conducted in Viet Nam. This makes it difficult to quantify the impact microfinance has had on clients. Nevertheless, given the very high repayment rates, low incidence of over-indebtedness, and repeat use by those clients who already have access, it is possible to conclude that the trillions of dong lent to microfinance clients have increased their purchasing power, giving them the opportunity to both stabilize their finances and take advantage of opportunities when they arise.

Another way to consider the socioeconomic impact of microfinance is through a gender lens. Financial inclusion efforts often explicitly target women, and this is very much the case in Viet Nam. Traditionally, the rationale for targeting women is that it enhances their equality, empowerment, and social inclusion.[5] Women have more limited access to resources than men in terms of education, time, and money. For example, women in the Asia and Pacific region spend between 60% and 84% of their time doing unpaid nonmarket work, including caring for their families and their home.[6] Because of their unpaid family and household obligations, women spend less time in their businesses per week than men, and they have less ability to pursue economically productive activities beyond the home.

Women also tend to be disadvantaged regarding ownership and control of assets because of long-standing norms or legal barriers. Women often have to deal with issues ranging from legal discrimination in asset ownership and control to social and cultural norms that limit their opportunities to lead a business or

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[4] CGAP. 2019. *Toward a New Impact Narrative for Financial Inclusion*. Washington, DC.
[5] F. Lotti. 2006. *Entrepreneurship: is there a gender gap?* Bank of Italy, Rome, Italy.
[6] World Bank. 2012. *World Development Report 2012: Gender Equality and Development*. Washington, DC.

to network.[7] Another constraint women entrepreneurs face is that they often have less say in important household and business decisions and divert business resources to household expenditures.[8]

In Viet Nam, the central role the Viet Nam Women's Union plays in MSPs and with Viet Nam Bank for Social Policies ensures that women are the primary beneficiaries of their services. Thus, microfinance has made a positive contribution to gender equality in Viet Nam. However, although microfinance has contributed to resilience, well-being, and gender equity in Viet Nam, the problem is that it has not done so for enough women. Many households remain unbanked or under-banked. The popularity of peer-to-peer lenders in Viet Nam demonstrates that there is demand for credit, even at high interest rates.

The National Financial Inclusion Strategy places considerable emphasis on banks serving the informal sector, either directly, through agents, or via digital finance platforms. However, the reality is that banks do not plan to expand into underserved geographic areas or into the "unbanked" market segment on a scale that would address the needs of the unbanked. They have limited appetite for unsecured lending. For example, when the Dariu Foundation was forced to close at the end of 2019 because of its foreign ownership structure, it still had 14,000 clients with good repayment histories. Repeated efforts to transfer this portfolio to another bank failed. No bank was interested in managing these loans. Fintechs and digital finance platforms are also not specifically targeting the poor and excluded.

The organizations that are designed to serve unbanked households are MSPs. Their impact is limited by their inability to grow. Without growth, inefficiencies because of poor economies of scale are not addressed. This means that the current approach to microfinance is not contributing effectively and sustainably to achieving the government's social goals. Achieving the targets in the National Financial Inclusion Strategy will require them to play a leading role.

For them to achieve their potential, they need not only wholesale funds, but also stronger commercial orientation. They also need a policy environment that encourages rather than impedes professionalization. In many ways, the current legal and regulatory framework contributes to these binding constraints on the sector by limiting both funding options and sources of leadership.

[7] United Nations Capital Development Fund. 2016. *Markets at Full Speed Women as Economic Drivers, Fuelled by Finance*. New York, NY.

[8] S. Eyerusalem. 2019. *Empowering women entrepreneurs in developing countries*. Brookings Institution, Washington, DC.

Reimagining Viet Nam's Microfinance Sector

Recommendations for Institutional and Legal Reforms

Viet Nam's new National Financial Inclusion Strategy issued on 22 January 2020, sets out targets for promoting financial inclusion by 2025. Achieving these targets requires considerable support from the microfinance sector as well as other stakeholders in the finance sector. This paper emphasizes the need to prioritize regulatory reform for microfinance development. Otherwise, the microfinance sector in Viet Nam could remain nonprofit rather commercial—making it difficult for the sector to attract wholesale funding. Aside from helping achieve the National Financial Inclusion Strategy, regulatory reform in the microfinance sector can also enable Viet Nam to become more active, prominent, and competitive on a regional level along with its neighbors in Asia.

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