SUMMARY PROGRAM IMPACT ASSESSMENT
Microfinance Development Program – Subprogram 2

I. Introduction

1. This program impact assessment (PIA) estimates the costs and benefits of the Microfinance Development Program (MDP) - Subprogram (SP) 2 highlighting the importance of the sector and adjustment costs required. The costs of the reforms are mostly indicative estimates except for a few which reflect the actual budget allocated by the Government. This assessment is divided into the following sections: (a) brief on the methodology adopted; (b) definition of the problem; (c) estimates of the costs and benefits of the subprogram.

II. Program Impact Assessment: Methodology

2. The methodology used for this PIA follows the regulatory impact assessment (RIA) tool commonly used to assess the impact of proposed regulations and other interventions in the economy. It provides a flexible methodology for the systematic analysis of reforms to ensure that policy objectives are attained in a cost effective manner. The PIA shows that: (a) net benefits from the proposed program outweigh the costs and maximize net benefits; and (b) the loan amount is commensurate with the adjustment costs of the reforms.

3. The program impact is evaluated by assessing the costs and benefits of the reform options. By recognizing the transmission channels of the reform measures, the impact of the policy reforms adopted is assessed through a qualitative description of policy reforms and its benefits. To the extent possible, the impact of reforms is quantified in dollar terms. The costs[1] to the government and statutory agencies are classified as; administrative costs, enforcement costs, and direct fiscal costs. Administrative costs represent those costs incurred by the government and relevant statutory agencies in implementing the program, while enforcement costs represent those costs incurred by the government and relevant statutory agencies in enforcing compliance and monitoring the implementation of the program. Direct fiscal costs include the costs of establishing new agencies or expenditure programs, budget increases, forgone revenue collection, etc. Both the benefits and costs of the proposed program are assessed to provide an estimate of net benefits.

4. This PIA is structured along the following steps: (a) definition of the problem and the regulatory objective of the program; (b) the definition of the expected impact and outcome of the proposed program; and (c) the assessment of costs and benefits.

III. Program Impact Assessment: Developmental Impact of the Program

A. Definition of the Problem

5. **Access to financial services remains inadequate**. Microfinance operations grew with the government support and ADB assistance in recent years. As of December 2013, some 10.4 million borrowers have about $8.2 million microfinance loans outstanding. Average microfinance loan size also increased from $719 to $814 from 2010 to 2013. Despite this progress, access to financial services remains inadequate as only about 11 percent of those whose income levels

[1] The estimation of costs from the reforms relies, when possible, on government estimates and official budget figures or budget proposals included in planning documents.

belong to the bottom 40% have an account in a formal financial institution (World Bank, Financial Inclusion Database, 2011). In terms of access to credit services, the rural areas, of which 72% of the population resides, had a mere 17% share of total bank credit. In terms of risk protection, only a small proportion of the population has an insurance policy as shown by the country's insurance penetration rate of only 1.5 percent implying a strong likelihood that those in the low-income sector have very minimal access to insurance services.

6. **Private sector participation in microfinance is limited.** State-owned financial institutions continue to dominate the microfinance market in Viet Nam. While the number of clients and the amount of loan outstanding of licensed microfinance institutions (MFIs) and people's credit funds (PCFs) increased, about 80% of the total number of microfinance clients and total microfinance loans outstanding were still provided by state-owned financial institutions, Vietnam Bank for Agriculture and Rural Development (VBARD) and Vietnam Bank for Social Policies (VBSP). The state-owned financial institutions continue to co-exist with more than a thousand member-based PCFs and some 50 semi-formal MFIs. As of December 2013, clients of licensed and unlicensed MFIs accounted for only 7% of all microfinance clients. To date, only two of the semi-formal MFIs have transformed into licensed formal MF institution.

7. **Continuing subsidy to state-owned financial entities engaged in micro-credit.** In compliance to the Prime Minister Decision 852 implementing the new VBSP development strategy for 2011–2020 which requires VBSP to have sustainable operations, VBSP increased its interest rates to align with the prevailing market rates. VBSP also promoted savings products among its clients. While this is clearly a move towards more sustainable VBSP operations, Government continues to provide subsidies[2] to the VBSP. With continuing government subsidy and without clear performance-based indicators prompting VBSP to be less reliant on subsidies, there is little incentive for VBSP to improve efficiencies or implement innovation in VBSP business processes and products. This limits the VBSP's capacity to provide a wider range of financial services to its clients.

8. **Long process involved in the drafting, issuance and implementation of relevant rules and regulations for MF limits, if not delay, private sector participation in microfinance.** The implementation of the Credit Institutions Law of 2010 (CIL 2010) allows semi-formal MFIs to transform and be part of the formal banking system. This signals and emphasizes the Government's resolve to move towards market-based provision of microfinance services. In particular, CIL 2010 addresses the overly complex, inefficient and restrictive policies of earlier issuances to encourage greater private sector participation in microfinance. To fully implement the law, the State Bank of Vietnam (SBV) is expected to issue and implement new regulations on MFI licensing and operations as well as establish appropriate prudential norms for MFIs safe operations. While draft regulations have already been completed, the need to conduct massive consultation with MFIs and key stakeholders resulted in the delayed issuance of these rules and regulations. In view of this, a number of semi-formal MFIs have postponed their application for formal MFI status.

9. **Weak financial and management capacity of semi-formal MFIs inhibits transformation into formal MFIs.** Most semi-formal MFIs in Viet Nam started as microfinance projects of social and political organizations. As such, their operations, systems and capacities are not geared towards formal bank operations. Most of them have inexperienced human resources and weak financial recording and reporting skills. With the lack of friendly rules and

[2] Estimated amount of subsidy for VBSP as of December 2013 amounts to about USD 371 million.

regulations that will guide formal microfinance operations, some semi-formal MFIs opt to retain their status and not transform into a formal MF bank.

10. **Limited and inadequate capacity for microfinance regulation and supervision**. The peculiar nature and characteristics of microfinance call for a different set of regulatory and supervisory skills. Recognizing this, SBV created a microfinance unit within its relevant Departments. Since microfinance is a relatively new area, most of the officers and staff of these units need to enhance their capacities on the formulation of relevant regulations and the implementation of supervisory procedures for microfinance.

11. **Absence of long-term on-lending funds to expand outreach.** There is currently no available wholesale facility for expanding microcredit operations of MFIs and even for VBSP, which is largely dependent on budgetary support. The availability of long-term funds for microfinance operations is important for continued sustainability of MFIs.

12. **Keen interest of private insurance providers in providing microinsurance is hampered by the lack of more detailed legal framework**. Recognizing the importance of risk protection among the low-income sector, private insurance providers have indicated a keen interest in providing microinsurance products and services. In particular, they are looking forward to the issuance of appropriate regulatory provisions that encourages and supports innovations in product, processes and procedures to enable insurance providers to offer and deliver appropriate and tailor-fitted insurance products and services to the low-income sector.

B. Intended Impact and Outcome of MDP-SP2

13. The Program is expected to have an impact of greater financial inclusion and deepened financial sector. The outcome will be increased access of low-income clients to diverse, sustainable and affordable microfinance services.

C. Options for Reform

14. The MDP-SP 2 was designed to continually assist the Government in several reform areas that are particularly intended to promote greater financial inclusion and deepened financial sector. Specific assistance was provided in the implementation of policy reform measures leading to the: (i) creation of a policy and regulatory environment conducive to an inclusive, sustainable, and market-oriented microfinance sector; (ii) strengthening of supervisory and regulatory capacities for a sound development of the microfinance sector; (iii) strengthening of microfinance operating financial institutions to provide diversified, responsive, innovative and sustainable services to the poor; and (iv) strengthening of the financial infrastructure for the microfinance sector.

15. **Creating a policy and regulatory environment conducive to an inclusive, sustainable, and market-oriented microfinance sector.** The establishment of a policy and regulatory environment that is conducive for sustainable market-based microfinance was done through the implementation of the key provisions of CIL 2010 and the National Microfinance Development Strategy (NMDS). Assistance was provided in formulating relevant rules and regulations (IRRs) for sound and responsive microfinance operations. Specific regulations on ownership and governance for PCFs, transparency in interest rates setting, promotion of pro-poor innovations on e-banking, reporting requirements for sex disaggregation of client data and customer protection were issued. Regulations on the licensing and prudential norms for MFI operations have been formulated for consultations with key stakeholders. Recognizing the

importance of risk protection, an interim measure providing guidance for pilot microinsurance projects was issued prior to the issuance of a comprehensive microinsurance legal framework in 2015. Government also provided fiscal incentives through reduced income tax applicable to MFIs and PCFs.

16. **Strengthening supervisory and regulatory capacities of microfinance sector regulators**. Supervisory practices and procedures have been tailor-fitted to the peculiar characteristics of microfinance. Supervision manuals and procedures consistent with the new IRRs under CIL 2010 were developed to consider the nature and peculiar characteristics of microfinance (i.e. large number of small accounts with highly frequent transactions). The officers and staff of the newly created microfinance unit within the Inspection Department of the Banking Supervisory Agency (BSA) were given capacity building assistance in the form of training and mentoring activities. Likewise, a pool of qualified supervisors from various supervisory entities, i.e., SBV, MOF, and MPI were trained to effectively supervise microfinance operating financial institutions, including VBSP. This is to build a cadre of supervisors and regulators within SBV (for PCFs and MFIs) and MOF (for VBSP) who are knowledgeable of microfinance.

17. **Strengthening credit institutions involved in microfinance to provide affordable and sustainable services to the poor.**

a. **Strengthening VBSP.** VBSP moved towards greater stability and increased sustainability with the approval of the Development Strategy for VBSP **(**PM Decision No. 852/QD-TTg)**.** VBSP has: (i) raised interest rates for loans to “near poor” households to approximate market rates; (ii) enhanced information and technology (IT) solutions for core banking and other services; (iii) consolidated multiple loan programs into single household accounts for better monitoring and control; (iv) designed and rolled out savings products for the credit and savings groups; and (v) developed other financial products and services.

b. **Strengthening the PCF system.** The government approved the transformation of Central People’s Credit Fund (CCF) into a cooperative bank (SBV Circular No. 31 /2012/TT-NHNN, issued November 2012). It was granted a banking license in June, 2013 and its chartered capital was increased to D3 trillion or $142 million (SBV Circular No.166/GP-NHNN). Apart from providing apex institution support for the PCF network, it was also deputized by SBV to monitor and supervise PCFs’ operations. The government also approved the increase of its chartered capital to D3 trillion ($142 million) and initially infused D948 billion ($45 million) into the new Cooperative Bank to strengthen its capital base.

18. **Supporting development of relevant infrastructure for the microfinance sector.** Relevant financial infrastructure to support the development of microfinance was established under MDP. To ensure that appropriate and relevant training on microfinance is made available to all key stakeholders, the Microfinance Center was established within the Banking Academy through SBV Decision No. 278 on December 27, 2012, with an initial budget of D7.9 million ($0.376 million) for 2013–2014. The Microfinance Center will develop and implement capacity building activities for microfinance stakeholders including policy makers, regulators, microfinance involved financial institutions and practitioners.

19. Recognizing the need to have good quality loan portfolio, credit institutions were required to report all credit accounts regardless of loan size (SBV issued Circular No.

03/2013/TT-NHNN). The Microcredit Information Exchange System (MIES) was set up within the Credit Information Corporation (CIC) towards the end of 2013. The system requires all microfinance operating financial institutions to submit and access up to date, accurate and reliable credit information of all borrowers of formal credit institutions. It provides a cost-effective and IT-enhanced credit checking system for microfinance operating CIs. The MIES will help microfinance operating CIS to avoid costly gathering of credit information of its numerous individual clients enabling them to properly select borrowers and maintain good portfolio quality. This will help reduce the risks of overlaps and over-financing of microcredit clients.

20. With fiscal support from the government and technical assistance from MDP, VBSP and the Cooperative Bank implemented advocacy and financial literacy programs on sustainable microfinance and microinsurance. These programs focus on, among other things, consumer protection and target all key stakeholders including leaders of credit and savings groups, concerned government agencies, people's credit councils, insurance companies, and mass organizations. These empower clients to have informed choices and thus have better access to microfinance.

D. Impact Analysis

21. The impact of policy and regulatory reforms usually extends over several periods. For purposes of this impact assessment, only static costs and benefits are considered. A dynamic assessment requires forecasting the levels of a wide range of variables over the medium to long term. Expected costs and benefits of the set of proposed reforms are then estimated based on the evolution of variables over time. For instance, the adoption of market-based policy and regulatory reform measures for microfinance would result in economy-wide benefits in the form of more efficient and more sustainable microfinance operations including VBSP and CCF/PCFs. Increased private sector participation is envisioned with more efficient and sustainable operations of state-owned institutions engaged in microfinance.

22. While a dynamic impact assessment would provide a more complete insight on the regulatory impact of reforms, only a short-term static analysis of the net benefits expected from the reforms is shown in this impact assessment. Substantial and important insights on the expected gains from the reforms are provided, all other things remaining the same.

E. Estimate of Benefits

23. The establishment of a policy and regulatory environment that promotes and supports the development of a market-based and sustainable microfinance sector will encourage increased private sector participation that will lead to more efficient microfinance operations. More efficient operations enable MFIs to reduce the costs associated with microfinance lending, leading to lower financial and transaction costs for borrowers. Efficient MFIs are also able to provide a wide range and diversified set of low-cost microfinance products and services that are tailor-fitted to the needs of low-income households. With lower microfinance costs, client-households are able to engage in greater economic activities that lead to increased income, higher expenditures and/or increased savings. More efficient microfinance operations also result in greater outreach leading to an increased access of the low-income sector to financial services.

24. **Improvement in MF savings**. The MDP regulatory reforms geared towards increasing access to microfinance services would result in increased number and amount of savings accounts. From 2012 to 2013, savings mobilized from microfinance clients increased by $188

million. This is largely due to the increased savings mobilization effort done by the VBSP and the formalization of 2 MFIs. Newly licensed MFIs were allowed to mobilize savings from the public. Note that the increased savings mobilization effort of VBSP was a result of the adoption and implementation of measures leading to more sustainable operations under the new VBSP development strategy.

25. **Improved operational sustainability of VBSP.** VBSP, the dominant provider of microfinance in the Viet Nam implemented a new development strategy leading to increased sustainability. The following measures were initially adopted: (i) raised interest rates for loans to "near poor" households to approximate market rates; (ii) enhanced IT solutions for core banking and other services; (iii) consolidated its multiple loan programs by single household accounts for better monitoring and control; (iv) designed and rolled out savings products for the credit and savings groups; and (v) developed other financial products and services. Adoption of these measures led to an improvement in the savings generated by VBSP. Likewise, the alignment of its highly subsidized interest rates to market rates and the adoption of enhanced IT solutions and improved loan monitoring systems also led to increased volume of loans provided by VBSP. The gradual increase of interest rates towards market rate resulted in increased interest payments of approximately USD34 million.

26. The reform of VBSP towards a market-oriented and sustainable institution will render fiscal savings of an estimated amount of about $155 million from reductions in direct subsidies. Savings come from the reduction of direct subsidy to the operational costs of VBSP. With the alignment of interest rates with the market and increased efficiencies resulting from the adoption of innovations in business procedures and processes, direct state subsidies to VBSP operations will be reduced. Also, with enhanced efficiencies, reduction in the indirect subsidies to VBSP (e.g. opportunity loss on capital infusions, borrowing from SBV, waiver of income taxes and deposit premiums) will continue to result in increased fiscal savings on the part of the government.

27. Similarly, the conversion of CCF into the Cooperative Bank and the strengthening of the PCF network will enable the PCFs to grow in number and resources leading to an increased contribution of the PCFs in the Cooperative Bank. Given a chartered capital of approximately USD142 million, a strengthened PCF network will enable PCFs to own approximately half of the new Coop Bank's equity leading to a fiscal savings of about USD71 million. The improved regulatory framework of PCFs will also allow them to increase their outreach and thus compete efficiently with other institutions turning over direct financial savings in financial costs and fiscal savings for the government.

28. The establishment of the financial infrastructure (i.e. microfinance center within the Banking Academy and the microfinance information exchange system within the Credit Information Corporation) is also contributory to the strengthening of financial institutions engaged in microfinance. The MF center will provide the necessary training to improve capacities of institutions engaged in microfinance while the MIES will provide useful information that would lead to improved portfolio quality.

Table 1: Summary of Benefit Estimates from MDP- SP 2

	Amount ($ million)	% Share of GDP
1. Improved MF savings mobilization	188	0.11
2. Strengthening and increased sustainability of the VBSP through: i) gradual alignment of VBSP interest rates with market rates; ii) adoption of enhanced IT system; and iii) improved loan monitoring system	34	0.02
3. Lower fiscal burden from reduction in direct subsidies	155	0.09
4. Strengthening of the Coop Bank/PCF network	71	0.04
Total	**448**	**0.26**

F. Estimate of Costs

29. The costs estimates consider all the costs borne by the concerned government agencies, relevant financial institutions and other stakeholders of the policy reforms arising from the implementation of MDP. Costs are classified into the following: (i) administrative costs (or directly derived from the implementation of the program by the government agencies); (ii) enforcement costs (incurred during the enforcement or regulations and monitoring of compliance); and (iii) fiscal costs (associated to required budgetary expenditures, foregone tax revenue, financial costs, etc).

30. On this basis, the estimate of costs associated with the implementation of reforms under the MDP-SP2 include the following:

Table 2: Summary of Cost Estimates from the MDP-SP2

Types of Costs	Government and Statutory Agencies	Amt ($ million)	Financial Institutions	Amt ($ million)
1. Administrative Costs		**64.0**		**69.0**
a. Legislative Initiatives	Drafting and Enactment of the Credit Institutions Law and its implementing rules and regulations	6.0		
b. Regulatory Initiatives	Drafting and issuance of various SBV circulars on:MFIs and PCFs' operations; transformation of the CCF into the Cooperative Bank; interest rates, consumer protection and electronic banking	13.0	Transformation of semi-formal MFIs into formal MFIs	2.0
	Conduct of consultations with stakeholders	10.0		
	Capacity Building for Officers and	15.0		

Types of Costs	Government and Statutory Agencies	Amt ($ million)	Financial Institutions	Amt ($ million)
	Supervisors at SBV, MOF and MPI			
c. Policy and Strategy Formulation and Implementation	MF Development Strategy and roadmap including setting up and functioning of the Microfinance Advisory Committee	8.0	VBSP Development Strategy	20.0
			Conversion of the CCF into the Cooperative Bank	20.0
			Conduct of financial literacy for VBSP and CCF clients	12.0
	National Strategy for Gender Equality	1.0		
	Conduct of a study on fiscal and regulatory incentives for microfinance	1.0		
f. Establishment of Financial Infrastructure	Installation, operation of the Microfinance Information Exchange System at the CIC	10.0	Establishment of the required system to comply with the reporting requirements of the CIC (for VBSP, Coop Bank and MFIs)	15.0
2. Enforcement Costs		**18.0**		
SBV supervision and examination	Supervision of MFIs, Cooperative Bank/PCFs and VBSP	10.0		
MOF supervision	Supervision of VBSP and pilot microinsurance projects	8.0		
3. Fiscal Costs		**48.7**		
	Equity Infusion to the Cooperative Bank	45.0		
	Budgetary allocation to the Microfinance Center	0.4		
	Reduced tax rate applied to MFIs	3.3		
Total		**130.7**		**69.0**
Total Estimated Costs 199.7				

31. **Program Financing** The government requested a loan of $50 million to finance Subprogram 2 (SP2) of the Microfinance Development Program (MDP) from the Asian Development Bank Special Resources. The size of the loan is based on the results of the impact assessment that shows that the adoption and implementation of reforms under MDP resulted in economic benefits amounting to approximately $448 million, which is about 0.26 percent of GDP. The benefits essentially came from the improved operational efficiencies of institutions engaged in microfinance resulting from the establishment and adoption of an enabling policy and regulatory environment and the use of market-based policies and interest rates. This was essentially implemented through the issuance of relevant rules and regulations, adoption of appropriate policies and strategies and building the capacities of relevant stakeholders (i.e. supervisors and regulators and financial institutions). The costs of the reform program in terms of government administrative, enforcement and fiscal costs is approximately $200 million providing about $248 million net benefits. The PIA shows that: (i) net benefits from the proposed program outweigh the costs and maximize net benefits; and (ii) the loan amount is commensurate with the adjustment costs of the reforms. The proposed loan also reflects the government's development financing needs and conforms to the overall financing requirement of the country partnership strategy for 2011 to 2014.