

Setting up a Modern Risk Management System

Vietnam: TYM - Tinh Thuong Microfinance Institution, Hanoi

1. Development relevanceⁱ

Economic and poverty context: Vietnam is a densely populated developing country that has been transitioning to a liberalized socialist market economy since 1986, while maintaining one-party control over government institutions and large state-owned corporations. The share of agriculture in economic output has continued to shrink from about 25% in 2000 to less than 20% in 2013. State owned enterprises account for about 40% of GDP today. The privately owned industrial and service businesses that make up the difference are overwhelmingly small or micro in size and often operate informally. Vibrant entrepreneurial activity is visible across the country, as the labor force continues to expand by about one million adults per year and formal employment growth lags behind the demographic developments.

Table 1: Vietnam Economic Indicators						
	2009	2010	2011	2012	2013	2014 (est)
Population (millions)	86.03	86.93	87.84	88.77	89.71	90.18
GDP growth	5.40%	6.40%	6.20%	5.20%	5.40%	5.50%
Inflation (consumer price index annual %)		8.90%	18.70%	9.10%	6.60%	5.30%
Trade balance (% of GDP)	-9.46%	-6.55%	-2.53%	4.47%	1.59%	-0.45%
Foreign Direct Investment (net) (% of GDP)	7.17%	6.90%	5.48%	5.37%	5.19%	
Net official development assistance and official aid received (% of GDP)	3.52%	2.54%	2.65%	2.64%		
Workers' remittances (% of GDP)	0.70%	7.10%	6.30%		6.18%	
Economic Freedom Indicator (Heritage Foundation, 0=low ; 100=high)	51.00	49.80	51.60	51.30	51.00	50.80
Governance Indicator (-2.5=worst; +2.5= best)	Voice & Accountability	-1.46	-1.48	-1.42	-1.39	-1.34
	Political Stability / Violence	0.24	0.11	0.17	0.24	0.22
	Government Effectiveness	-0.25	-0.26	-0.23	-0.29	-0.30
	Regulatory Quality	-0.62	-0.61	-0.59	-0.68	-0.65
	Rule of Law	-0.47	-0.53	-0.48	-0.50	-0.49
	Control of Corruption	-0.53	-0.63	-0.62	-0.56	-0.53

Table 2: Vietnam Poverty Indicators						
	2009	2010	2011	2012	2013	2014 (est.)
GDP per capita (current USD)		\$1,334	\$1,543	\$ 1,755	\$ 1,911	\$ 2,083
Gini Index, Income Concentration		39.30%		35.60%		
Multidimensional Poverty Index, OPHDI Country total (0=not poor; 1=poorest)			0.017			
Poverty ratio using OPHDI MPI (% of population)			4.20%			
Poverty ratio at \$1.25 a day (PPP) (% of population)		3.90%		2.40%		
Poverty ratio at national poverty line (% of population)		20.7%		17.2%		
Rural poverty ratio at national poverty line (% of rural population)		26.9%		22.1%		

Vietnam's economic development has in recent years been held back inter alia by an undercapitalized banking sector and the impact of the global financial crisis. From a peak in 2011 of 8.6% non-performing loans across all commercial banks, the State Bank of Vietnam has organized a bank restructuring and non-performing loans resolution program that should bring system-wide non-performing loans back down to 3% in 2015.

Poverty rates have declined measurably since 2000, which in large part is owed to the dynamics of small and micro entrepreneurship.

Financial sector: Vietnam displays relatively high financial inclusion rates for a developing market, but the quality of financial services are skewed by the large presence of subsidized and inflexible state players: most importantly the Vietnam Bank for Social Policy (VBSP) with over 7 million micro-borrowers and a loan portfolio of USD 5.8 billion. Vietnam Bank for Agriculture and Rural Development (VBARD) lends primarily on a secured basis for larger rural projects but is also an important provider of savings and remittance services for rural populations.

More than 1'200 People's Credit Funds (PCF) with 1.7 million members collectively hold more than USD 1 billion in outstanding loans and USD 750 million in savings. The cooperative banking model has been somewhat discredited by its poor performance in the 1990s and is coming progressively under state control. With a USD 143 million capital injection from government, the Central Credit Fund, the cooperative apex institution, has been converted into a cooperative retail bank in 2013.

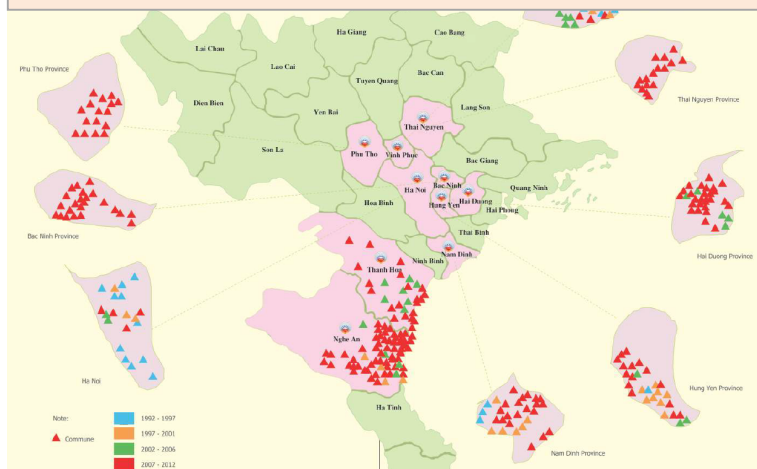
Despite the heavy state involvement, the demand for accessible and commercially sustainable micro-financial services is far from satisfied, particularly in rural areas, among economically active women as well as among the less educated, lower income strata of the population in general. Credit penetration rates appear higher in rural areas thanks to VBSP and VBARD loans, but this funding is rationed, bureaucratic to obtain and often simply not available when there is an urgent business requirement.

Partner Financial Institution: TYM is the first fully licensed microfinance bank in Vietnam and the only large scale microfinance

Table 3: TYM - Tinh Thuong Microfinance Institution - Key Figures						
USD '000	Dez 09	Dez 10	Dez 11	Dez 12	Dez 13	Okt 14
Total Assets	12'309	16'566	21'495	28'303	31'635	41'085
Gross loan portfolio	9'957	14'886	20'122	23'055	28'610	33'720
Total Deposits	2'472	3'725	5'876	10'643	13'717	17'394
Total Clients	40'433	55'146	73'636	84'090	96'127	104'281
Total Staff	210	264	339	362	377	397
Total Branches & Transaction Offices	40	45	45	52	53	56
Exchange Rate USD/VND	17'941	18'932	20'828	20'980	21'036	21'246

provider operating in the Northern part of the country. Recently M7 Group and Thanh Hoa Fund For Poor Women have also begun operations in Northern provinces. Since inception in the early 1990s, TYM has demonstrated the viability of a commercial/social double bottom line business model that is juxtaposed to the traditional loss-making and unpredictable government lending interventions. Its success in scaling up savings outreach to non-borrowers ("clients") since 2012 is being closely watched by stakeholders: non-borrower deposits in December 2011 stood at USD 43k and by December 2014 exceeded USD 4 million.

Figure 4: TYM Branch Network and Communes Served (Dec 2012)



The Microfinance Strategy put forward by the 2009 National Council on Microfinance clearly articulates the need for a level playing field among a diversity of microfinance providers and calls for reduction in subsidized lending to arbitrarily selected beneficiary groups. TYM is an obvious agent of change that has the scale and innovative energy to overcome the market distortions created by state intervention and contribute to the consolidation of efficient and sustainable providers of quality financial services to the poor.

TYM is owned by the Vietnam Women's Union and has always been committed to empowering women, particularly in the

most vulnerable rural poverty contexts. To this day, it serves exclusively women and is managed by a talented team of female executives. The core products of savings and credit are systematically accompanied by non-financial services that enhance women's roles in the community and in business, while remaining vigilant against the widespread issue of domestic violence.

2. Intervention approach

Capacity Building Needs: The objective of this technical assistance intervention is to create an independent analytical risk management function at the Head Office as this will be an essential cross-cutting enabler of sustainable growth.

Project Activities: Following a rigorous assessment of current risk management practices supported by IFC in 2012, the SCBF retained Dr. Joachim Bald as Risk Management Consultant to TYM between July 2013 and December 2014. The first step was to fully entrench with management and staff the rationale for a forward-looking, independent risk management function. The consultant helped identify the suitable Risk Manager designate and proceeded to train the designate and her alternate as well as the key interfaces for risk management at the executive level, in accounting/finance, branch operations, Human Resources and Internal Audit. The training conveyed the analytical skills and data management tools to effectively treat the full scope of risks incurred today and in the foreseeable future: client and counterparty credit risk, operational risk including AML/CFT and business continuity, liquidity, interest rate risk and foreign exchange rate risk. The training culminated in the adoption of the Risk Management Framework Policy describing the roles and responsibilities of the Board, Executive Management, Internal Audit and the Risk Manager in identifying, measuring and managing any and all exposures at TYM. The Framework Policy is the common roof for integrating specific policies for various risk dimensions. In the context of the intervention, TYM further developed a detailed Asset Liability Management policy that summarizes the analytical tools, exposure limits and the organizational processes for managing liquidity, interest rate risk and forex exposures. The consultant coached the Risk Manager and her key counterparts in performing the statistical analyses that flow into the independent risk reporting and in developing the underlying databases that are essential for fully implementing an analytical, data-driven approach to risk.

Additionality: The intervention is conceived as a catalyst that encourages TYM to blaze a trail for the financial inclusion of rural poor – who are clearly underserved by sustainable, cost-appropriate services from

private sector institutions in the North of the country. The intervention achieves additionality by accelerating and augmenting a level of service delivery that would otherwise simply not happen or only with delay and would run a risk of set-backs due to inappropriate product design or resulting from insufficiently managed operational and credit risks.

3. Results achieved

3.1. Client level

Effective risk management will in due course support the further expansion of sustainable and cost-appropriate financial services to vulnerable and previously excluded populations. It would be going too far to claim a direct link between the project intervention and the outreach achievements that have materialized in parallel. Risk Management is a long term investment, it will pay back with the next major crisis in credit or operational risk avoided or mitigated.

Table 5: TYM Geographical Outreach

Province	Branch name	Clients				Gross Loan Portfolio USD mln				Total Deposits USD mln (excl. staff)			
		Oct.14	Dec.13	Dec.12	Dec.11	Oct.14	Dec.13	Dec.12	Dec.11	Oct.14	Dec.13	Dec.12	Dec.11
Hanoi	Soc Son	4'619	3'941	3'734	3'669	1.493	1.311	1.223	1.187	0.990	0.904	0.621	0.506
	Me Linh	2'184	1'937	1'893	1'764	0.730	0.643	0.603	0.614	0.473	0.359	0.272	0.214
Vinh Phuc	Phuc Yen	7'220	6'915	5'825	4'896	2.462	2.135	1.684	1.861	1.327	1.080	0.876	0.685
Hung Yen	Kim Dong	6'666	6'373	6'190	5'640	1.898	1.691	1.482	1.697	1.085	0.974	0.822	0.538
Nam Dinh	Y Yen	5'773	5'217	5'108	4'883	1.556	1.440	1.180	1.325	1.016	0.752	0.660	0.551
	My Loc	2'527	2'133	1'496	817	0.955	0.678	0.397	0.241	0.382	0.279	0.136	0.050
	Nam Truc	2'778	2'283	1'480	1'041	0.948	0.575	0.374	0.196	0.347	0.244	0.160	0.038
	Hai Hau	2'196	1'719	1'202	487	0.634	0.433	0.246	0.127	0.280	0.145	0.087	0.017
Nghe An	Hung Nguyen	5'278	5'404	5'483	5'411	1.374	1.369	1.332	1.450	0.987	0.819	0.718	0.490
	Nghi Loc	12'779	12'293	11'511	9'722	3.617	3.563	2.921	2.772	2.427	1.828	1.406	0.882
	Do Luong	3'995	3'370	2'896	2'484	1.143	0.949	0.675	0.725	0.516	0.339	0.318	0.183
	Dien Chau	12'396	10'419	8'270	7'020	4.179	3.090	2.025	1.867	1.400	1.002	0.743	0.408
Hai Duong	Gia Loc	5'783	6'199	6'726	6'096	2.043	2.177	2.359	2.353	1.056	0.984	0.871	0.548
Thanh Hoa	Quang Xuong	10'967	10'795	8'800	7'779	3.778	3.159	2.443	1.953	1.507	1.196	0.958	0.468
Thai Nguyen	Song Cong	5'576	5'053	3'928	3'474	1.974	1.612	1.271	1.197	0.996	0.728	0.499	0.302
Bac Ninh	Bac Ninh	7'334	6'695	5'709	5'171	2.724	2.241	1.862	1.704	1.098	0.954	0.584	0.372
Phu Tho	Viet Tri	6'210	5'116	3'839	3'673	2.210	1.543	1.081	0.826	0.968	0.641	0.368	0.141
10	17	104'281	95'862	84'090	74'027	33.72	28.61	23.16	22.10	16.86	13.23	10.10	6.39
provinces	branches	clients	clients	clients	clients	USD mln	USD mln	USD mln	USD mln	USD mln	USD mln	USD mln	USD mln

TYM scores high on social performance ratings and its operational model ensures a solid rural and pro-poor client focus. In 2013, it conducted a trial with the Progress out of Poverty Index. However, this index or other statistical measures of quality of life are not yet systematically applied for client targeting and the system does not permit to retain full scope results in a structured database for analysis. The growth of the "policy loan" product may serve as a proxy indicator for the growing outreach to the poorest members. Policy loans are targeted at women living below the national poverty line and are extended at special low rates backed by a dedicated capital grant from the Vietnamese Government that TYM obtained in 2012. Since launch in early 2013, policy loans have grown to 2.8% of the total portfolio or USD 1'176k.

The value added by TYM can best be appreciated by following typical members and their businesses over time.

Ms. Nguyen Thi Thu – Hung Nguyen Branch: "I was born in 1981. After getting married, both my husband and I did not have steady jobs. We tried to grow food with unreliable income. Our life was very difficult. We decided to switch from agriculture to selling gas and gas stoves. At first, we ran into trouble for lack of capital and business knowledge. Also, the demand for gas and stoves at the time was very limited, since we lived in an agricultural area with low living standards.

In 2004, I joined TYM to get loans for investment in our business. Since then, I have participated regularly in the activities of my TYM center and in the community more generally. I have learned a lot and gained

opportunities to develop personal and business relationships. The funds from TYM are important for our



business. I tried to use them wisely for specific trading and service opportunities: With the first loan, I invested in buying more gas cylinders. With the income earned plus the following loans, I invested in upgrading the kiosks and in stocking other accessories such as gas stoves, pots, pans... We have diversified our range of products offered. Besides, we have also invested in tools for my husband's business, which has contributed to a stable income for my family and our employees. Over time we learned how to best use local labor and bring in family members to help us. We even did a market survey to understand the needs of local residents in the surrounding areas. That is why we diversified our goods and looked for new sources of supply and transportation. We also have had to find ways to formalize our business in line with the law to

ensure both the social security of our employees and the safe handling of the gas supplies. By now, we not only have a stable income but we also create jobs for 10 employees including 6 regular ones. In the next 2 years, we are going to expand our business, upgrade the kiosks, increase our storage volume and reach new markets."

Ms. Tran Thi Thoa lives in Tu Dan commune on the dike protecting the Khoai Chau district, Hung Yen province. This area is the main source of green-bean vermicelli for the province. Ms. Thoa is a member of the Women's Union unit at Duong ward, Tu Dan commune. In 2009, before joining TYM, her family was in crisis. She had suffered mental illness and incurred medical expenses that had drained her family's savings and she had to take out expensive personal loans. She and her husband were under enormous strain trying to repay all the loans and feeding their family. At that time, she was introduced by the Women's Union to TYM, so that she might obtain a new loan on favorable terms to invest in her business and generate income. She was reluctant to take on another loan at first, but borrowed VND 5 million for improving her vegetable stall in the local market. As her business grew, she returned to TYM for bigger loans over the years and expanded her store in the market. She now also sells milk, bread, breakfast portions, etc. At the same time, her husband helped her with her business and launched other activities in the neighborhood to supplement their income. The family has pulled itself out of the hardship of poverty and managed to repay all loans and build a steady income. Ms Thoa has three children, all are going to school, two are in secondary school, one is in high school. In 2013, the family made the bold decision to borrow VND 15 million from TYM to renovate their shabby house and invest a small part into her husband's motorbike garage. As an active member of TYM, Ms. Thoa also worked as a cashier for the TYM centre, where the weekly transaction meetings are held in her community. No matter how busy she is with her store and housework, she still finds time to volunteer for TYM since 2009.



3.2. Partner financial institution level

The most important achievement of the technical assistance project has been to entrench an independent analytical perspective on the risks engaged across all aspects of operations. Taking one of their most talented young managers "out of production" and moving her into a largely self-defined analytical role that sometimes challenges management's view of the facts is not to be underestimated. This represents a difficult change in organizational culture, particularly at a time when the existing business model is obviously well

Table 7: Key Performance Indicators

	Dez 09	Dez 10	Dez 11	Dez 12	Dez 13	Oct-2014 (annualized)
Annual Net Income - USD	764'014	720'315	254'469	1'059'969	1'387'920	1'850'748
Return on Average Assets %	6.73%	4.99%	1.34%	4.26%	4.63%	5.09%
Return on Average Equity	19.6%	15.1%	5.3%	16.8%	16.2%	18.9%
Capital Adequacy Ratio (Basel 1)	43.1%	32.2%	21.9%	32.8%	30.7%	29.0%
Portfolio Yield - Average	23.33%	23.99%	22.06%	26.78%	24.01%	22.55%
Portfolio at Risk, 30+ days	0.02%	0.02%	0.07%	0.03%	0.03%	0.02%
Social Performance - Targeting / Outreach to Poor, max=100% (Cerise)					76.0%	
Social Performance - Social Responsibility, max=100% (Cerise)					84.0%	
Social Performance Rating, 0-low; 5 best (Planet Rating)		"4."				
USD/VND Exchange Rate (end of period)	17'941	18'932	20'828	20'980	21'036	21'246

a key role in identifying and mitigating operational risk and developing the credit risk assessment methodology under the micro and small business lending product initiative supported by IFC. Furthermore, the Risk Officer has launched an IT Strategy Working Group chaired by the Head of Internal Audit that plans and prioritizes bug fixes and new functional requirements for the existing AsiaSoft platform, while evaluating alternatives for a new core banking solution. The Risk Officer developed a functional specification and working prototype in MS Access of an Operational Risk Management System (Loss Event Database). The Risk Officer furthermore provides quality assurance and independent risk review on key contracts and policy documents of TYM.

4. Lessons learnt and further challenges

There is still a challenge to fully institutionalizing risk management at TYM in that some of the technical risk management skills have been invested only in the Risk Officer and the Head of Internal Audit. A special effort was made to involve all key operational interfaces in the training sessions, but the hard analytical details and data management tools were mainly mastered by the Risk Officer, the Head of Internal Audit and the informally designated Alternate Risk Officer. The role of alternate was initially filled by a staff member of the International Department. After this person left TYM in November 2014, the Deputy Head of Finance was brought up to speed as the alternate risk officer, specifically in respect to asset liability management. There is concern that there would be no immediately available replacement across the full scope of risks, should the current Risk Officer leave TYM or be reassigned to other management duties. It is recommended that TYM nominate a deputy risk officer who can be trained by the current risk officer as soon as possible. An internal auditor or an analytically minded accountant or credit manager would be a suitable profile.

Compared to other microfinance banks globally, there is a relatively "light touch" board-level involvement in guiding TYM's business strategy and only limited visibility of second level Risk Management before the Board. Executive Management is reluctant to bother the Board with too much operational detail or raise concerns with extensive risk discussions, since the business is obviously well managed and profitable and the incidence of credit and operational risk is extremely low. However, this approach brings with it the latent risk of a sudden strategic misalignment with the Board and the Women's Union, particularly in a situation where TYM might face unexpected losses on its portfolio or a serious operational incident.

The current AsiaSoft banking is inefficient and inadequate for modern data-driven risk management. As an ad-hoc measure, the Risk Officer now monthly patches together a full inventory of loan and deposit transactions and client static data and stores these snapshots in a basic data warehouse for subsequent analysis. The core banking system is the largest strategic and operational risk TYM is facing today and progress on urgent improvements has been slow. Management has been cautious not to rush into the large investment required for a modern core banking system (> USD 2 million), while it is not entirely clear how the system selection relates to the potential creation of a bank. Helping in determining a sound system development strategy appears to be an important area for future technical assistance and is planned by IFC.

controlled within the operational hierarchy ("1st line of defense") and actual losses from credit and operational risk are negligible.

Since April 2014, the full-time and independent Risk Officer provides independent monthly activity and exposure reports to the Executive Risk Committee. She also actively participates in the new product / new markets approval process. She plays

Figure 8: Weekly member meeting for loan and savings transactions at a community center.



ⁱ Sources of indicators in Table 1: World Bank Development Indicators (data.worldbank.org); Heritage Foundation Economic Freedom Index (heritage.org); Worldwide Governance Indicator (Worldbank.org). Abbreviations in Table 2: OPHI: Oxford Poverty & Human development Initiative; MPI: Multidimensional Poverty Index.