



Banking

I. Introduction

The global financial crisis has dominated world news during 2009. It has been generally agreed that local policy makers and the State Bank of Vietnam (SBV) have responded quickly and decisively to tackle the problems that have arisen as a result of this crisis. In addition to the fiscal stimulus package, the Government has called upon the financial sector to cooperate with the government's interest rate subsidy scheme for working capital and later for capital investment under Decision 131 and 443 respectively. These programs have been effective in preventing a prolonged economic downturn and have helped return the country to economic growth and hence ensuring social protection.

Further, in its appreciation of the importance of the banking sector, the implementation of Decree 22 has enabled five international banks to establish wholly foreign-owned subsidiaries this year. To ensure the banking sector continues to grow and support the development goals of the country, EuroCham has re-examined some of the issues that confront the banking sector in order to continue the drive for improved efficiency and stability in the years ahead. In line with our position paper last year, three "pillars" need to be addressed to the State Bank of Vietnam and the Government:

1. **Roadmap:** A forward looking roadmap for the banking industry, harnessing market forces rather than administrative restrictions to continue the drive for growth;
2. **Market efficiency:** Efficiency and clarity in the way the market and the regulations should work so as to ultimately reduce the "cost of delivery" of banking products and services to businesses and consumers;
3. **Consumer Banking:** Clear guiding principles and removal of major impediments for the Consumer Banking and Consumer Finance industries.

II. Roadmap (Pillar 1)

1. Law on Credit Institutions / Scope of activities of foreign bank branches (FBB) and 100% foreign owned banks (WFOB)

A specific, unambiguous and comprehensive law governing credit institutions is crucial to successfully attract investment and promote growth in financial services. A major step forward in this area was made with the production of the Draft Law on Credit Institutions. We also acknowledge the continuous efforts made by the Government in seeking to improve this draft law through consultation with industry participants and impartial external experts. To create a market environment that will foster continued growth, it is imperative that the final legal framework is robust, transparent, in line with international best practices and open to innovation. To achieve these goals, we recommend further review of the following areas:



Article 88.2 of the Draft Law provides that “credit institutions are not permitted to carry out activities outside the scope of activities stipulated in the license granted by the SBV”. This implies that credit institutions are restricted only to deposit taking, credit extension and payment services. With regard to other operations such as foreign exchange, gold trading, credit card issuance, foreign currency operations, etc. a credit institution must establish a subsidiary or affiliate for that purpose.

We note that these restrictions differ significantly from international norms and may materially restrict the development of financial services in Vietnam. Additionally, these restrictions are contrary to Circular 03 of the SBV dated 5/6/2007 implementing Decree 22 dated 28/2/2007, which states that FBBs and WFOBs are permitted to carry out activities outside the scope of activities stipulated in the license if:

- The SBV has accepted in writing; or
- There is a specific regulation in relation to a particular activity which states that FBBs or WFOBs are subject to such regulation and are permitted to carry out such activity.

Recommendation: We recommend that the law provide flexibility to the SBV to add services and activities as appropriate. The extension of internationally standard banking services is a common practice and commercial banks should be allowed to perform not only the services as stated in their licenses, but also any additional services accepted by the SBV. We suggest Article 88.2 of the Draft Law be amended in accordance with the principles of Circular 03.

2. Lending limit for a single borrower

Under Article 128 of the Draft Law, the total credit balance provided to a customer shall not exceed 15% of the local own equity of a locally incorporated bank or a FBB that provides the loan. Article 128 of the Draft Law would have a negative impact on FBBs in Vietnam. All FBBs in Vietnam have maintained a number of loans to single customers up to 15% of the own equity of its parent bank. If Article 128 of the Draft Law is applied, the FBBs will be either in breach of this Article or in breach of the existing loan contracts for early termination. Additionally, this article would prevent small foreign bank branches from conducting business in Vietnam and would serve as a significant deterrent to new entrants and further investment. FBBs have been crucial in providing onshore financing for FDI, infrastructure projects and many of the local industries in Vietnam. Should this article be enacted, further offshore financing will be required which may cause deferment of investment and/or significantly increase costs and foreign currency risks.

Recommendation: Under Decree 22, a FBB is a dependant branch of the parent bank and therefore the FBB’s loans should be determined in accordance with the parent bank’s own equity. Accordingly we suggest Article 128 be amended in accordance with Decision 457.

3. Consolidation of banking sector

There remain over 80 banks in Vietnam, where the top 20 banks are estimated to do the bulk of the banking business. The bottom 25% of banks are undercapitalized and could pose a threat to confidence in the banking system through their instability and lack of



critical mass. The Government has made good progress in addressing this issue, most significantly through Decree 59, which increases the minimum legal capital for joint stock banks from VND1 trillion to VND3 trillion, which may lead to consolidations, mergers and acquisitions in the banking sector. In preparation for this, it is critical that any banking consolidation is supported by a legal and procedural framework that ensures clarity in process and speed in action.

Recommendation: The Draft Circular on Mergers and Consolidations of Credit Institution should be reviewed in conjunction with industry participants and external experts to ensure that the application process is straight-forward and the approval process is centralized with the SBV to ensure that the consolidation process can be completed rapidly in order to ensure stability in the banking system.

4. Foreign shareholdings in local banks

Decree 69 states that the total foreign shareholding in a local Vietnamese bank should not exceed 30% and that, within this limit, the maximum shareholding permitted to an international bank as a “strategic partner” is 15% (which can be increased to 20% with the Prime Minister’s approval). The increase in maximum shareholdings is welcome progress on Vietnam’s WTO commitments. A roadmap for further deregulation of foreign shareholdings should be developed.

Recommendation: There is need for clarity on scope and timing of further increases in shareholding as this would enable both the strategic partner and the local banks to devise more definitive plans. Such clarity will eventually lead to a much more constructive and planned approach for the banking sector in Vietnam.

5. Clearing system

Establishing a highly reliable and efficient settlement and clearing system is a key component of the financial infrastructure required to ensure further development in the banking sector. While clearing systems have been improved over the past several years, further progress is required in order to ensure the foundation is in place to support further economic growth.

Recommendation: The SBV should work with industry participants to create an efficient and reliable clearing system that:

- Satisfies business continuity requirements;
- Facilitates automated/electronic transfers across the entire country;
- Clears major transactional currencies (VND and USD);
- Guarantees liquidity requirements (appointing a lender of last resort); and
- Ensures security requirements.

II. Market Efficiency (Pillar 2)

1. FX regulations and FX Policy



Decree 160, issued since December 2006, clearly lays out the framework for dealings between participants and FX products in Vietnam. However, the key implementing circulars have not been issued to provide guidance for participants in conducting their FX activities in line with the new law and environment. This has slowed down the development and the depth of the FX market – factors especially relevant in the current environment of high volatility where exporters/importers need to use more sophisticated hedging techniques so as not to be disadvantaged vis-à-vis their competitors operating in other countries.

More importantly, the current FX policy in regarding to the band of USD/VND limit the supply of USD in the FX market. This adversely impact the trade flows and foreign investment into Vietnam market as the uncertainly surrounding the health and convertibility of Vietnam Dong.

Recommendation: We recommend urgency in issuing clear implementing circulars for Decree 160 thereby participants can operate their FX activities smoothly under the same ground rule and can cope with the current market environment. The State Bank of Vietnam should consider adopting measurements to improve the confidence in the Vietnamese Dong and increase the liquidity in the FX Market.

2. Interest rate cap

The government has made positive progress on deregulating the consumer banking market by lifting the interest rate cap for consumer lending in 2009. This move provided the foundation to create a viable, innovative and accessible consumer finance market in Vietnam. Consumers now have more choice as commercial banks have introduced a range of new consumer lending products, including a variety of new home loans, car loans, and construction and renovation loans. The remaining interest rate cap on commercial lending continues to restrict banks from pricing risk effectively, and as such, may prevent lending to those companies that most needs bank financing.

Recommendation: The government should remove the interest rate cap from the civil code and empower the State Bank of Vietnam with more discretion to set interest rates. It is of course vitally important that the government is able to quickly react to market conditions and effectively set interest rate policy. This can be best achieved through harnessing market forces in the bond market rather than through a fixed administrative mechanism which restricts banks from pricing risk effectively, and can retard industry growth.

3. Rating agencies

Rating agencies play a critical role in market efficiency, especially in the disintermediation process. To achieve this effectively, experience in other markets has shown that rating agencies need to be formed within the country to enable a wide cross-section of companies to access their services and to enable them to gradually enter the bond and commercial paper markets with “rated paper”. The introduction of rating agencies also plays a transformational role in areas like accounting practices, corporate governance, etc., thereby leading to a more efficient market with greater transparency.



Recommendation: The government should encourage the setting up of at least 1 or 2 “independent” rating agencies within Vietnam to undertake the above.

4. Close Out Netting and Set-Off

Currently, there is no regulation that addresses netting of market transactions. While trading partners within Vietnam may agree to offset their positions or obligations, it is unclear whether these agreements are permissible or enforceable under current local laws. Besides reducing transaction costs, netting is a critical tool for efficient markets as it reduces credit and liquidity risks, and ultimately systemic risk. Additionally, given that netting results in more favorable capital treatment for credit risks, netting arrangements are crucial for Vietnamese-domiciled banks as it may help to improve their credit ratings when they participate in the international markets in order to hedge their positions.

Recommendation: The government should work with industry and external experts to develop regulation on close out netting and set-off in line with international best practice.

5. Regulatory reporting

Currently there are approximately 100 regulatory reports that a bank has to send to the State Bank of Vietnam or the government, ranging from daily to annual frequency. Whilst it is fully appreciated that timely and accurate reporting of critical data enables the regulator to monitor the state of affairs, all reporting adds to manpower costs both within the bank and at the SBV. This ultimately adds to the “cost of delivery” of finance to the end customer.

Recommendation: It is recommended that a working group comprised of the SBV, banks and the World Bank be created to review and overhaul the reporting requirements to ensure that reporting is appropriate and robust and unwanted duplication of reports is eliminated.

6. Offshore borrowings

Vietnam’s long term economic growth and infrastructure development will require substantial long-term debt capital to be raised from offshore capital markets. One of the impediments towards Vietnamese companies from accessing the international capital markets is the imposition of “withholding tax” on interest paid to offshore lenders. This has led to companies shying away from accessing the capital markets and relying on mismatched short-term loans from the onshore Vietnamese market.

Recommendation: The government has made progress on addressing this issue through the ratification of Double Taxation Agreements with several jurisdictions. The government is encouraged to continue to negotiate double taxation agreements with additional jurisdictions and to ensure a straightforward process is implemented to allow organizations to efficiently claim tax credits allowed under these agreements. The government should also consider the waiver of withholding tax on interest payment to offshore lenders for loan tenors over one year to encourage potential borrowers to tap this important pool of funding.



III. Consumer Banking (Pillar 3)

1. Wealth Management Products

Wealth management products are now globally a core offering for banks to its retail clients. This has proved advantageous for consumers, given that banks provide significant oversight and expertise to ensure that products are appropriately provided to customers by proper assessment of client's risk appetite and purpose.

Recommendation: Given that current regulation is silent on investment products, the government is encouraged to bring into place a law that allows commercial banks to offer investment products to their customers, provides protection to investors in the sales process, and requires transparency in the pricing/returns and risks of such products.

2. Credit Bureau

Consumer lending in Vietnam is still at a nascent stage and in order to ensure its healthy growth Vietnam should have a "credit bureau" where all banks are required to feed in information on each individual's overall borrowing from the banking system. The creation of such a bureau would allow all banks to observe the borrowing track record and behavior of individual customers which can help to lower costly mistakes and make it easier for good borrowers to obtain finance.

Recommendation: Credit bureaus should be set up in Vietnam with compulsory inputs from all banks and financial companies.