The Banking Regulation Review

Second Edition

Editor
Jan Putnis

Law Business Research

THE BANKING REGULATION REVIEW

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THE BANKING REGULATION REVIEW

Second Edition

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Chapter 45

VIETNAM

*Samantha Campbell, Pham Bach Duong and Nguyen Thi Tinh Tam**

I INTRODUCTION

Vietnam's current banking system can be traced back to 1988 when four state-owned banks, the Bank for Foreign Trade of Vietnam ('Vietcombank'), the Vietnam Bank for Industry and Trade ('Vietinbank'), the Bank for Investment and Development of Vietnam ('BIDV') and the Bank for Agriculture and Rural Development of Vietnam ('Agribank'), were separated from the State Bank of Vietnam ('SBV') with a mandate for commercial banking activities.

The public banking sector, composed currently of five state-owned commercial banks ('SOCBs', commercial banks in which the state retains an interest greater than 50 per cent), still dominates the market.

Since Vietnam's accession to the World Trade Organization ('WTO') effective 1 January 2007, the government has been pursuing a policy of partial privatisation (known in Vietnam as 'equitisation') of some of the state-owned banks with a view to opening up and attracting funds to the banking sector. Of note, Vietcombank equitised in 2007 with the state retaining a 91 per cent stake, and Vietinbank equitised in 2008 with the state retaining an 89 per cent interest.[1] The equitisation of other state-owned banks, BIDV in particular,[2] and the prospective increase of shareholdings in already-equitised banks to be held by the public, are generally perceived to be proceeding more slowly than investors had hoped, due in part to the global financial crisis.

Another trend in Vietnam is the increasing presence of foreign banks, typically pursuing their activities in Vietnam through the establishment of branches or representative

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1 In January 2011, the International Finance Corporation ('IFC') and its affiliate subscribed up to 10 per cent of the shares of the bank. This is the first acquisition of a participation by a foreign investor in a SOCB.

2 Mekong Housing Bank recently received SBV approval to equitise.

offices, or both. In 2009, following a change in legislation,[3] the SBV granted five licences permitting HSBC, Standard Chartered, ANZ Bank, Korea's Shinhan Bank and Malaysia's Hong Leong Bank to establish entirely foreign-owned subsidiary banks incorporated in Vietnam.

Foreign banks have also, sometimes in parallel with other forms of local presence, acquired minority 'strategic stakes' in most of the important Vietnamese banks.

The Vietnamese banking sector has weathered the global financial crisis relatively well. This is due in a large part to its relative isolation from the international financial markets. The perception in the market is that the SBV responded quickly and well to the crisis by promulgating a fiscal stimulus package and an interest rate subsidy scheme that limited the impact of reduced international demand for Vietnamese exports. These measures have now been withdrawn for the most part in the face of the SBV's main current challenges: the depreciation of the Vietnamese dong and potential inflationary growth. Memories of an inflation rate of up to 28.3 per cent witnessed in August 2008 are still vivid and it currently stands at about 12.2 per cent.

Currently Vietnamese banks are principally lenders to large corporations, including a high proportion of state-owned enterprises ('SOEs'), although the sector remains relatively unsophisticated. Consumer banking is still in its early stages and remains undeveloped.[4] Low market penetration is viewed as providing potential for expansion into lending to smaller enterprises and consumer banking as income levels rise. GDP growth in 2011 is predicted to be in the region of 6 to 7 per cent,[5] which increases the Vietnamese banking sector's attractiveness from an investment perspective, with Vietnamese and foreign banks vying for market share.

Although the Vietnamese banking and finance sector is growing rapidly, there is still a significant lack of know-how, management experience and enforceable governance controls.

II THE REGULATORY REGIME APPLICABLE TO BANKS

Banking activity in Vietnam is governed by the Law on the State Bank of Vietnam ('the SBV Law') and the Law on Credit Institutions ('the LCI') both passed on 16 June 2010 and effective on 1 January 2011,[6] as well as a number of implementing decrees, circulars and decisions issued by the government, the SBV and the Ministry of Finance.

The cross-border supply of banking services into Vietnam is heavily restricted by Vietnamese law. Offshore banks may generally not provide services to Vietnamese

3 Decree 22/2006/ND-CP dated 28 February 2006 issued by the government of Vietnam on organisation and operation of foreign bank branches, joint venture banks, banks with 100 per cent foreign-owned capital and representative offices of foreign credit institutions in Vietnam ('Decree 22').

4 In 2008 only 17 per cent of the population had a bank account: *Moody's Global Banking*, Vietnam, August 2009, p6.

5 Vietnam Development Report 2011, The World Bank, p. 19.

6 The new laws replace the Law on the State Bank of Vietnam and the Law on Credit Institutions adopted in 1997 and amended in 2004.

entities, with the notable exception of hard currency loans (which are subject to strict exchange control regulations).

The SBV performs the traditional role of a central bank and regulates the banking system in Vietnam by working closely with the Ministry of Finance and the SBV's network of provincial branches. Through its Banking Inspection and Supervisory Agency,[7] the SBV is the authority empowered to grant establishment and operating licences to banks in Vietnam. The State Securities Commission ('the SSC') regulates all securities activity in Vietnam, including securities activities carried out by commercial banks.

The scope of a credit institution's permitted activities is specified in its banking licence. Banks may only participate in the domestic and international foreign exchange and gold markets, including in respect of international payment services, upon receiving specific permission from the SBV.[8]

A commercial bank may undertake deposit taking activities, provided it opens its own deposit account at the SBV with the minimum compulsory reserve level. Although there is no statutory stipulation relating to the deposit interest rate that a bank must apply, they are *de facto* limited under voluntary agreements between the SBV and the Vietnam Banking Association. The most recent agreement was reached in December 2010[9] with the aim of cooling the interest war that had been fuelled by illiquidity. This agreement has caused all banks to offer deposit interest at around the 14 per cent limit (while trying to work around it with various promotions).

Banks may also, of course, conduct lending activities and, with effect from April 2010, the statutory ceiling on the interest rate (fixed by the Civil Code at 150 per cent of the basis rate announced by the SBV, and lifted in 2009 with respect to consumer-lending activities only) was removed with respect to all forms of bank loans in local currency.[10] The removal of the cap on dong lending was confirmed in the new LCI.[11] Vietnamese banks may not, however, lend to off-shore entities without specific SBV approval, rarely granted on a case-by-case basis.

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7 Established by Government Decree No 96/2008/ND-CP dated 26 August 2008 ('Decree 96').

8 As from 30 March 2010, banks and gold traders are no longer permitted to trade gold on onshore and offshore accounts under Circular 01/2010/TT-NHNN dated 6 January 2010.

9 Official Letter of the Vietnam Banking Association number 250/HHNH dated 15 December 2010.

10 Circular 12/2010/TT-NHNN of the SBV dated 14 April 2010 replaced Circular No. 07/2010/TT-NHNN dated 26 February 2010 which at the time only partially removed the cap on dong lending interest rate for commercial medium and long-term loans to borrowers operating in the areas of 'production, business, services and investment for development'.

11 The LCI provides that the credit institutions and clients are entitled to negotiate on interest rates and fee for loans in accordance with the laws of Vietnam (Article 91.2). However, if required by the circumstances a cap on interest rates and fees charged by credit institutions may be re-imposed by the SBV in order to ensure the safety of the banking system (Article 91.3).

Banks are also not permitted to provide loans to enterprises that they control and that operate in the securities sector, nor are they permitted to provide unsecured loans for investment in any business in the securities sector.[12]

As well as the usual deposit-taking and lending activities, a commercial bank may also act as a custodian bank for securities following receipt of a registration certificate from the SSC with the function of providing depository services and supervising the management of public funds and securities investment companies.[13] The assets that the bank manages as custodian must be held separately from its other assets. The duties of a custodian bank can also include the certification of reports prepared by a fund management company or securities investment company (as applicable).

A commercial bank may operate as an agent to provide insurance products and services for Vietnamese customers through its banking channels with the approval from the SBV.[14]

Banks established in Vietnam must operate under one of the following permitted forms:

a state-owned commercial bank established and organised in the form of a one member limited liability company where 100 per cent of the charter capital is owned by the State;[15]

b joint stock commercial bank (i.e., a company limited by shares);

c joint venture commercial bank established and organised in the form of a limited liability company;[16] and

d entirely foreign-owned commercial bank established and organised in the form of a limited liability company.[17]

Mutual structures are contemplated by law and exist most commonly in rural areas under the similar forms of cooperative banks and people's credit funds. Limited liability

12 Article 126.4 of the LCI.

13 Article 98.2 and Article 6.14, Law on Securities.

14 Article 106 of the Law on Credit Institutions; as an example, Standard Chartered Bank was licensed in January 2010 to provide insurance agency services.

15 Once the equitisation of SOCBs is completed as currently envisaged by official decisions there will remain only one wholly state-owned commercial bank. SBV Decision 214/QD-NHNN dated 30 January 2011 approved the transformation of the Agribank into a one member limited liability company owned by the State and there are no plans currently for it to equitise.

16 There are currently only five joint venture banks in Vietnam: Indovina Bank Limited, Vietnam Russia JV Bank, ShinhanVina Bank, VID Public Bank and Vinasiam Bank.

17 Banks established off-shore may operate in Vietnam through a wholly owned subsidiary and/or branches or representative offices with a more limited scope of permitted activities. Unlike its predecessor, the new LCI does not consider foreign bank branches as a form of credit institution. This has created a number of issues in relation to the interpretation of the scope of current banking regulations which referred to foreign bank branches as credit institutions authorised by the SBV to operate in Vietnam (Article 4.8 and 4.9 of the LCI).

micro-finance institutions can also be established to provide credit services to individuals, households and micro-enterprises.

i Restrictions on foreign ownership in Vietnamese banks and foreign banks

Despite the liberalisation of the banking sector, the acquisition by foreign entities of a shareholding in a Vietnamese commercial joint stock bank is still subject to significant restrictions. All such acquisitions must be approved in writing by the governor of the SBV.[18]

As a rule, the total aggregate shareholding of foreign investors in a Vietnamese bank may not exceed 30 per cent of its 'charter capital'.[19] The total aggregate shareholding of a foreign credit institution and its affiliated persons must not exceed 10 per cent,[20] and the shareholding of any single foreign investor and its affiliated persons (not being credit institutions), may not exceed 5 per cent[21] of the charter capital of a Vietnamese bank.[22]

However, the law does permit a foreign 'strategic investor'[23] and its affiliated persons to acquire up to 15 per cent[24] of the charter capital of a Vietnamese bank and a number of foreign banks have, in the last five years, made such acquisitions.[25] In special cases, the Prime Minister, based on the proposal of the governor of the SBV, may permit a foreign strategic investor to purchase up to 20 per cent of the charter capital of a Vietnamese bank.[26] In addition to the acquisition restrictions, Vietnamese law also locks in strategic investors for five years and other foreign credit institutions for three years from the acquisition.[27]

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18 Article 5 of Decree 69/2007/ND-CP dated 20 April 2007 and issued by the Government of Vietnam on foreign investors purchasing shares of Vietnamese commercial banks (Decree 69).

19 Article 4.1 of Decree 69.

20 Article 4.3 of Decree 69.

21 Article 4.2 of Decree 69.

22 Article 4 of Decree 69.

23 Defined as 'a reputable foreign credit institution with financial capacity and the ability to provide assistance to a Vietnamese bank during the development of banking products and services, raising managerial and executive capability, and applying modern technology, and which has strategic advantages connected with the strategy for development of the Vietnamese bank, which satisfies the specific criteria stipulated by the Vietnamese bank'.

24 Article 4.4 of Decree 69.

25 At the current time: Standard Chartered Bank: 15 per cent of Asia Commercial Bank (ACB), HSBC: 20 per cent of Vietnam Technological and Commercial Bank (Techcombank), United Overseas Bank: 15 per cent of Phuong Nam Bank (Southern bank), Sumitomo Mitsui Financial Group: 15 per cent of Export Import Bank (Eximbank), Malayan Banking Berhad: 20 per cent of An Binh Bank (AB Bank), Societe Generale Bank: 15 per cent of Dong Nam A Bank (SEA Bank), BNP Paribas: 15 per cent of Phuong Dong Bank (Oricombank), Deutsche Bank: 10 per cent of Hanoi Building Bank (Habubank), Oversea-Chinese Banking Corporation: 15 per cent of Bank for Private Enterprises (VP Bank) and Commonwealth Bank of Australia: 15 per cent of Vietnam International Bank (VIB).

26 On 17 August 2008 HSBC increased its interest in Techcombank to 20 per cent.

27 Article 13.1 of Decree 69.

Since 1 April 2007 – and in accordance with Vietnam's WTO accession undertakings – entirely foreign-invested banks, in which one of the foreign shareholders is a 'parent bank' holding a majority equity interest, may be established in Vietnam.[28] The parent bank must have total assets of more than US$10 billion at the end of the year prior to application. Entirely foreign-owned banks must comply with Vietnamese prudential requirements on a stand-alone basis.

Foreign banks may also open branches as subsidiary units with no separate legal status.[29] The parent bank must have total assets of more than US$20 billion at the end of the year prior to application. A foreign bank branch may not open transaction points at locations other than its registered branch office, which, in practice poses real practical problems for the expansion by foreign banks of their activities in Vietnam.

Some foreign banks operate through representative offices, which are prohibited from conducting commercial operations in Vietnam.[30] A representative office merely acts as a link between the parent bank and their clients in Vietnam. As such, its activity is generally limited to market research and the promotion and follow-up of the offshore parent entity's activities involving Vietnamese credit institutions or companies.[31]

III PRUDENTIAL REGULATION

i Relationship with the prudential regulator

The SBV controls the banking activities of all banks licensed to operate in Vietnam through the delegation of specific powers to internal departments of the SBV. The Banking Inspection and Supervisory Agency of the SBV is specifically designated to examine the operations and activities of credit institutions.[32]

All banks must send a vast number of periodic reports to the SBV, varying from those required on a daily basis to those required on an annual basis. This is regarded as contributing to an unwieldy and ultimately costly banking environment. In addition, banks must immediately report to the SBV irregular developments that are adverse to the business operations of the bank or major changes to the organisational structure of the bank.[33] Notwithstanding the volumes of reporting required, there is a clear lack of sophisticated information disclosure relating to the activities of banks, in particular from an accounting perspective.

A bank is required to obtain written approval from the SBV prior to making any changes to its corporate identity, including a change to its name, capital, location, scope of business, and management, listing on off-shore stock exchanges (although this has not yet occurred), as well as significant changes to its shareholding structure.[34]

28 Article 5.4 of Decree 59.

29 Article 7.4 of Decree 22.

30 Article 7.7 of Decree 22.

31 Article 62 of Decree 22.

32 Decree 96.

33 Article 141 of the LCI.

34 Article 29 of the LCI.

ii Management of banks

The laws and regulations concerning the management of commercial banks as well as the role and responsibility of the shareholders[35] are now detailed in the new LCI. Provisions of Decree 59/2009/ND-CP dated 16 July 2009 on organisation and operation of commercial banks ('Decree 59'), adopted shortly before the new LCI was passed are also applicable to the extent they are not contrary to the LCI.

The management structure of an entirely state-owned bank, a joint-venture bank or a bank with entirely foreign capital (as opposed to a bank which is a company limited by shares or a joint stock commercial bank) corresponds to that of a limited liability company and is constituted by the members' council, the board of controllers and the general director.[36] In relation to a joint-stock commercial bank the board of management is responsible to the shareholders for the operation of the bank. Both the members council and the board of management should consist of between five and 11 members.[37] For joint-stock commercial banks, at least half of the members must be independent and members who are not executive officials of the credit institution.[38] In both types of structure, the board of controllers is constituted by at least three members, at least half of whom must be full-time.[39]

Subject to the decisions that are reserved at law or are in the bank's charter for decision by the owners (in limited liability structures) or shareholders, the members council or the board of management has the authority to make decisions in the name of the bank and to exercise the rights and obligations of the bank, in particular with respect to investment and asset acquisition decisions with a value of more than 20 per cent (for limited liability banks) and 10 per cent (for joint-stock commercial banks) of the charter capital of the bank.[40] The general director has authority for transactions of lesser amounts.

The shareholders of a joint-stock bank must by law approve investments and acquisitions and sales valued at more than 20 per cent of the bank's charter capital and contracts with a value of more than 20 per cent of the bank's charter capital between the bank and its management (members of the board of management, or of the board of controllers, or the general director), or between the bank and major shareholders, i.e., shareholders holding at least 5 per cent of the bank's charter capital, or their respective related parties and between the bank and its affiliates.[41] In a limited liability bank all transactions of the bank with the members of the members council or its top management, or both, must be approved by the members council.[42]

The board of management, the members council or the owner (in case of a one-member limited liability bank) may appoint one of its members (if applicable) or employ

35 Articles 66 and 70 of the LCI.

36 Article 32 of the LCI.

37 Article 62.1 of the LCI.

38 Article 62.1 of the LCI.

39 Article 44.2 of the LCI.

40 Article 63.8 and 67.2 of the LCI.

41 Article 59.2(p) and (q) of the LCI.

42 Article 67.2(l) of the LCI.

another person as the general director. The general director manages the daily business of the bank, supervised by the board of management or the members council and the board of controllers and is responsible to the board of management or the members council.

Each of the board of management or the members council, the board of controllers and the general director acts for a term of five years and may be reappointed for an unlimited number of terms. The election and appointment of the chairman and members of the board of management or the members council, the head and members of the board of controllers, and the general director of a bank must be ratified by the governor of the SBV, and their duties and powers must be specified in the charter of the bank.

Any individual or any institutional shareholder represented by an individual who is a member of the board of management or the members council, board of controllers or a general director may not, while he is in office, sell his shares. This provision in the new LCI varies from the previous rule under Decree 59 which required the retention of only 50 per cent of the total number of shares owned when elected or appointed to the relevant managerial position during the term of service and for a period of one year thereafter.[43]

A foreign bank branch in Vietnam may be managed by only one general director who may not be a manager or executive of any other credit institution or economic institution in Vietnam.

Currently there is no specific regulation under Vietnamese law limiting the payment of bonuses to the board of management and employees of a banking institution. However, under general Vietnamese corporate law, the board of management and the general director of an enterprise (which may include a bank) may not receive a salary increase or bonus payment if the enterprise is not able to pay all its due debts.

Regulatory capital

Vietnamese legislation does contain prudential requirements and separate debt provisioning guidelines.[44] However, the SBV does recognise that Basel II is far from being implemented in Vietnam and it aims for gradual implementation over the coming years.

i Capital adequacy

In 2010, consistent with its stated intention to tighten prudential requirements, the SBV raised the minimum capital adequacy ratio ('CAR') of credit institutions (excluding

43 Article 56-1 of the LCI and Article 36.4 of Decree 59.

44 Circular 13/2010/TT-NHNN dated 20 May 2010 ('Circular 13') replaced the Regulations on Prudential Ratios in Operations of Credit Institutions issued with Decision No. 457/2005/QD-NHNN of the Governor of the SBV dated 19 April 2005 (Decision 457), as amended by Decision No. 03/2007/QD-NHNN of the SBV dated 19 January 2007, Decision No. 34/2008/QD-NHNN dated 5 December 2008 and Decision 493/2005/NHNN on classification of debts ('Decision 493'). Circular 13 was amended by Circular 19/2010/TT-NHNN dated 27 September 2010.

foreign bank branches) to 9 per cent from the previously applicable 8 per cent. The ratio is calculated as the percentage of 'equity' over 'total assets in credit at risk'.

For the purposes of this capital adequacy test, 'equity' comprises: (1) tier 1 capital, including charter capital, the reserve fund for supplementing the charter capital, the professional development investment fund, the investment and development fund, retained profits, shares issuance premium received and added to the capital less the amounts used to repurchase shares (as the case may be); and (2) tier 2 capital, including 50 per cent of the additional value of fixed assets following their revaluation, 40 per cent of revalued financial assets, financial reserves, long-term unsecured subordinated convertible bonds and other deeply subordinated debt instruments. tier 2 equity cannot exceed tier 1 equity.[45]

Items that must be deducted from the equity of a bank include: (1) in relation to tier 1 capital only, good will, operating losses including accumulated losses, contributions to the capital of other credit institutions or subsidiaries, significant investments over 10 per cent of the total of all components of tier 1 capital after deduction of all preceding items, and investments over 40 per cent of the total of all components of tier 1 capital less all preceding deductions;[46] (2) the reduced value of fixed assets following their re-valuation by the bank; and (3) the total amount of the reduced value of all types of financial assets following their revaluation.[47]

'Total assets in credit at risk' comprises the value of assets in credit of a bank which are adjusted at risk levels ranging from zero to 250 per cent[48] plus off-balance sheet undertakings which are adjusted at risk levels from zero to 100 per cent.[49]

In addition to the individual bank's capital adequacy ratio, the new LCI now requires banks having subsidiaries to calculate a consolidated capital adequacy ratio for the group using a similar methodology.[50]

45 Article 5.3 of Circular 13.

46 Article 5.2 of Circular 13.

47 Article 5.4 of Circular 13.

48 Article 5.5 of Circular 13. There are six categories of assets in credit depending upon the level of risk: 1) cash and gold or equivalent: zero per cent; 2) debt recoverable from other credit institutions or equivalent: 20 per cent; 3) investments in projects under finance companies and claims secured by immoveable property: 50 per cent; 4) paid-up charter capital in subsidiary companies and affiliates, claims on non-OECD Governments and financial institutions: 100 per cent; 5) loans to non-securities trading subsidiaries and affiliates: 150 per cent; and 6) loans made for investment in securities and real estate: 250 per cent.

49 Article 5.6 of Circular 13; the risks co-efficient of the value of off-balance sheet undertakings are: zero per cent for an undertaking guaranteed by the government or the SBV, fully secured by cash or by savings accounts or deposits of valuable paper issued by the government or the SBV; 50 per cent for an undertaking secured by immoveable property; 100 per cent for interest rate and currency transactions and other off-balance sheet undertakings.

50 Article 6 of Circular 13.

ii Large exposures and related party transactions

A commercial bank's total credit exposure (including guarantees)[51] to a single borrower is limited to 15 per cent of its equity.[52] The new LCI subjects foreign bank branches to the same restrictions by imposing that the single borrower limit calculation be based on the branch's allocated on-shore capital instead of the parent bank's equity (as was the case under the previous regime). Only those foreign banks committed to investing in Vietnam in the long term while remaining in the branch form have made provision for such change to the single borrower limit calculation by allocating additional capital to the relevant branch in order to comply with the new prudential ratios.[53]

The aggregate amount of credit exposure to a group of related clients must not exceed 25 per cent of a commercial bank's or foreign bank branch's equity.[54]

The above limits do not apply where loans are extended under trust lending arrangements whereby the bank acts as an agent for on-lending of funds provided by other organisations or where the borrower is a credit institution.

In exceptional cases, the Prime Minister can authorise the above single borrower and related borrowers credit exposure caps to be raised to up to 400 per cent of the equity of the credit institution or foreign bank branch.[55]

The total amount of credit exposure by a credit institution to any single enterprise or all enterprises that such credit institution controls[56] must not exceed 10 or 20 per cent, respectively, of the credit institution's equity.[57]

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51 'Credit exposure' includes loans, discounting, finance leasing, factoring or bank guarantees, investment in bonds issued by a client and other forms of extension of credit (Article 4.14 and 128 of LCI). Therefore, going forward bank guarantees are also included in the 15 per cent single borrower limit while previously the maximum aggregate exposure in loans and guarantees to a single client was 25 per cent of a credit institution's equity. This significant tightening was strongly debated prior to the adoption of the new LCI.

52 Article 128.1 of the LCI.

53 In late December 2010, the SBV approved capital increases for Huanan Commercial Bank Ltd. Ho Chi Minh City ('HCMC') Branch from US$15 million to US$65 million, Chinatrust Bank HCMC Branch from US$15 million to US$50 million, and Mizuho Corporate Bank Hanoi and HCMC Branches from US$15 million to US$133.5 million each.

54 Article 128.1 of the LCI.

55 Article 128.7 and 128.8 of the LCI.

56 These include subsidiaries or affiliated companies of the credit institution or an enterprise controlled by the credit institution (Article 127.1(e) of the LCI). Control is defined as 'an investment accounting for more than 50 per cent of the charter capital or voting shareholding capital of any one enterprise, or another investment sufficient to control decisions of the general meeting of shareholders or members' council' (Article 4.25 of the LCI).

57 Article 127.4 of the LCI.

iii Use of short-term funds

A commercial bank may only use 30 per cent of its short-term mobilised funds (i.e., that are repayable within one year) to finance medium and long-term loans.[58]

iv Liquidity ratio

The minimum liquidity ratio that a commercial bank must maintain in respect of each type of currency and gold is 15 per cent of defined liquid assets (including cash and cash equivalents) over liabilities due immediately. This ratio increases to 100 per cent of liquid assets in dong, US dollars, euros and British pounds being claimed within seven business days against liabilities payable within that time period and the aggregate amount of certain contingent liabilities payable within the subsequent seven business days. [59]

v Equity investments

Under the new LCI, commercial banks must establish or acquire subsidiaries or associated companies to carry out underwriting of securities issues, securities brokerage, management and distribution of securities investment fund certificates, securities portfolio management and sale or purchase of shares, finance leasing and insurance.[60] They may not exercise these activities directly. However, with the exception of finance companies, the creation or purchase of such subsidiaries, or even the exercise of their control by the bank, seems to be quite restricted due to the cap on the maximum level of investment that a bank and its subsidiary and affiliated companies can make in an enterprise operating in such sectors as insurance, securities, management of security assets, foreign currency remittances by Vietnamese residing abroad, trading in foreign exchange or gold, factoring, issuance of credit cards, consumer credit, payment services or credit information or investment fund or investment project. This cap is set by the law at 11 per cent of the enterprise's or fund's charter capital or 11 per cent of the value of the investment project. The total investment made by a credit institution (including its subsidiaries and affiliated companies) must not exceed 40 per cent of its own charter capital and its reserve fund.[61]

Commercial banks, the most active participants in Vietnam's nascent corporate bond market, are seeking to clarify whether the above restrictions will prevent them from underwriting bonds as a practical matter.

vi Loss provisioning and debt classification

Decision 493 imposes loss provisioning requirements on commercial banks and a debt classification regime. This piece of legislation introduced for the first time the possibility for a credit institution to classify debt on a qualitative basis, based on its own, SBV approved, internal credit risk-rating systems ('ICRS'). In view of the lack of guidance regarding the establishment of ICRS, each credit institution is establishing its own system and there is a consequential lack of consistency in the classification of debts and

58 Circular 15/2009/TT-NHNN dated August 10, 2009.

59 Article 12 of Circular 13.

60 Article 103.2 of the LCI.

61 Article 129.1 and 129.2 of the LCI.

in the establishment of prudential ratios. The SBV is preparing a draft Circular to replace Decision 493 with a view to providing consistent guidelines on ICRS.

IV CONDUCT OF BUSINESS

In order to protect depositors, a commercial bank must maintain compulsory deposit insurance with Deposit Insurance of Vietnam, which is a state financial institution, in respect of Vietnamese dong deposits and transactions.[62]

The LCI prohibits banks from disclosing any details relating to a client unless it is requested by customers, by the general director of a deposit insurance organisation, or by a state body during an inspection or for the internal activities of the bank.[63] There is no other general duty of confidentiality applicable to banks.

Without the consent of depositors, a bank cannot carry out investigations into deposits or to freeze a deposit, deduct from or transfer deposits, except in the limited case of being requested to do so by a competent court or a judgment enforcement authority.[64]

A bank must not conceal or provide services in respect of money that has an illegal origin and must immediately notify the competent state body (the Anti-Money Laundering Agency under the SBV) as soon as they are aware of such circumstances.[65] Under new detailed legislation effective from 1 January 2010,[66] banks must put in place internal anti-money-laundering rules on customer information, reporting suspicious transactions and coordination with law enforcement agencies. The new regulations also contain internal training and annual audit requirements. A new department under the Banking Inspectorate at the SBV has been established to take charge of all matters regarding money laundering.[67] A bank violating the money-laundering regulations may be subject to administrative sanctions ranging from a warning to a monetary fine of up to 30 million dong.[68] Individuals committing money-laundering offences may be subject to criminal sanctions, including prison terms of between one and 15 years.[69]

Depending on the nature and seriousness of other banking violations, a bank may be subject to administrative penalties which range from a warning or a fine up to 70 million dong, or suspension of operations, with or without a specified time-limit (e.g.,

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62 Decree 89/1999/ND-CP dated September 1, 1999 on deposit insurance ('Decree 89') amended by Decree 109/2005/ND-CP dated August 24, 2005 ('Decree 109'), The government is currently planning to upgrade the current deposit insurance regulations into a law replacing Decrees 89 and 109.

63 Article 5 of Decree 70/2000/ND-CP dated 21 November 2000.

64 Civil Proceeding Code and Law on judgment enforcement.

65 Article 11 of the LCI.

66 SBV guidance for the implementation of money-laundering measures (Prevention and Combat). Circular No. 22-2009-TT-NH dated 17 November 2009.

67 Decision 1654/QD-NHNN dated 14 July 2009 on functions, duties, powers and organisational structure of the anti-money-laundering department.

68 Article 24 of Decree 74/2005/ND-CP dated 7 June 2005 on anti-money laundering.

69 Article 251 of the Criminal Code of Vietnam.

withdrawal of the operation licence).[70] There is no publicly available information relating to the imposition of any such sanctions to date.

V FUNDING

Joint stock banks in Vietnam frequently raise funds by share or convertible bond issuances.[71] Under the LCI, Vietnamese banks may also finance their operations through 'mobilised capital', which may consist of: (1) cash deposits; (2) borrowed capital from domestic and foreign credit institutions; (3) funds raised via the issuance of valuable paper, such as time deposit certificates or bonds; and (4) borrowed capital from the SBV.

As the central bank, the SBV may refinance commercial banks by re-lending in accordance with credit contracts, discounting or rediscounting valuable paper or by granting loans guaranteed by pledges of valuable paper.[72] The SBV's refinancing policy is one of the ways in which it supplements short-term capital and provides payment means for commercial banks.

In extraordinary cases for the purpose of stabilising the monetary market, the SBV may grant special loans to commercial banks that may be insolvent causing a threat to the stability of the banking system.[73] During the financial crisis, the SBV has not officially granted any special loans to a bank on this 'emergency basis', although it did in January 2010 inject 15,000 billion dong in open-market transactions to improve the liquidity of commercial banks.

VI CONTROL OF BANKS AND TRANSFER OF BANKING BUSINESS

i Control regime

Other than in the case of state-owned banks, entirely foreign held bank subsidiaries and joint-venture banks, Vietnamese law prohibits any shareholder that is an organisation from holding, directly or via proxy, more than 15 per cent, and any individual from holding, directly or via proxy, more than 5 per cent, of a bank's charter capital.[74] The combined shareholding of shareholders and their related parties is also limited to 20 per cent.[75]

70 Decree 202/2004/ND-CP on administrative offences in the field of money and banking.

71 By way of example, most recently Saigon Thuong Tin Bank (Sacombank) increased its charter capital from 5,115 billion to 6,700 billion dong and Export-Import Bank (Eximbank) increased its charter capital from 7,219 billion to 8,800 billion dong through share issuances.

72 Article 11 of the SBV Law.

73 Article 24.2 of the SBV Law and Article 151 of the LCI. The SBV refinanced a private bank, Asia Commercial Bank ('ACB') when there was a run on the bank in 2003 resulting from rumours that the General Director had absconded.

74 Article 55.1 and 2 of the LCI.

75 Article 55.3 of the LCI.

In special cases in the national interest, the Prime Minister may, at the SBV's request, permit shareholdings in commercial banks that exceed the statutory limitations.[76]

The governor of the SBV must provide prior written approval of: (1) the purchase and sale transactions of 'significant shareholdings' (defined as 'a level of shareholding of 5 per cent or more of the voting share capital of a bank'); and (2) purchase and sale transactions of an amount of shares that results in any shareholder holding more than a significant shareholding or any shareholder no longer holding a significant shareholding.

The SBV may not approve such a transaction if it considers that it may lead to 'instability in banking operation'.[77] Since this term is not defined and is potentially broad, the SBV has, in practice, a fairly wide discretion in approving transactions. Note also the restrictions on foreign ownership in Vietnamese banks set out in Section II, *supra*.

The SBV last year issued Circular 04[78] governing the merger, consolidation and acquisition of credit institutions, which replaced prior legislation that was narrower in scope.

Circular 04 permits the merger of commercial banks into an existing entity, and the consolidation of commercial banks into a new entity, subject to prior written approval of the Governor of the SBV.[79] The SBV will evaluate the file and the opinions of the local SBV branch and the people's committee of the province or city where the relevant banks have their head office. Factors taken into consideration when considering whether to approve or refuse the merger, consolidation or acquisition plan will be the current organisational and operational status of the banks and the impact of the merger or consolidation (as the case may be) on 'social stability' within the locality.[80] Any merger or consolidation is also subject to competition approvals and the satisfaction of minimum capital and prudential requirements.

ii Transfers of banking business

Other than through the merger or consolidation activity previously described, a bank cannot transfer its clients' bank deposits to another entity without receiving specific approval from the SBV.

It may however assign its loan arrangements to a foreign or domestic purchaser (subject, in the case of an assignment to a foreign entity, to compliance with exchange control procedures). The terms of any such assignment are freely negotiable with the sole

76 Article 34.4 of Decree 59.

77 Article 36 of Circular 06/2010/TT-NHNN dated 26 February 2010 guiding organisation, management and executive operation, charter capital, assignment of shares, and amendment of and addition to licence and charter of commercial banks ('Circular 06').

78 Circular No. 04/2010/TT-NHNN dated 11 February 2010 on mergers, consolidations and acquisitions of credit institutions ('Circular 04').

79 Article 34 of the Law on Credit Institutions.

80 Articles 10.4, 14.4 and 18.4 of Circular 04.

exception that certain 'group 1 standard debts', being very well-performing loans, may only be sold at the value of the debt.[81]

The debtor and any guarantors must unconditionally accept the assignment of the creditor's rights from the seller to the buyer of the debt.[82] The security for any transferred debt will also follow the debt to the benefit of the assignee, without the need for borrower consent (unless the security contains specific transfer restrictions), although the re-registration of the security may sometimes be problematic from a practical perspective.

Decree 59 also contains a special control and bankruptcy regime applicable to all forms of commercial banks, including state-owned banks, which allows the SBV to appoint a special committee to oversee a bank experiencing financial difficulties. The appointment of such a special committee is not automatically disclosed to the public. The SBV also issued further specific guidelines on bankruptcy procedures applicable to credit institutions, which took effect on 15 March 2010.[83] This provides that a credit institution that is incapable of repaying its due debts upon the request of its creditors only be subject to insolvency procedures after the SBV has determined to terminate the special control regime in writing. The same approach was adopted by the authors of the new LCI.

VII THE YEAR IN REVIEW

Although Vietnam's banking sector seems to have benefited from 6.5 to 6.7 per cent growth rate of the country's GDP[84] with the majority of commercial banks posting profits, due to persisting macroeconomic imbalances, 2010 remained a relatively challenging period. Growing concerns over the state of the Vietnamese economy, exacerbated by the inability of Vinashin, the Vietnamese state-owned ship-building company, to repay foreign debt obligations, the balance of payments and the questionable stability of the financial system led to the downgrading of Vietnam's credit rating to B+ by Fitch in July, and, in December, to BB- by Standard & Poor's and B1 by Moody's.

At the beginning of 2011, monetary policy is dominated by the desire to control inflationary pressures and stabilise prices without jeopardising growth. In early November 2010, the SBV decided to raise the base (prime) rate by 100 basis points bringing it to 9 per cent, and in February 2011 to the central bank raised its refinancing rate to 11 per cent.[85]

Overall extension of credit was estimated to have only increased by 29.81 per cent by 31 December 2010 (year-on-year), a marked reduction in comparison to the 45.6 per

81 Article 7.1 of Regulation on purchase and sale of debts by credit institutions issued by Decision 59/2006/QD-NHNN dated 21 December 2006 ('Decision 59').

82 Article 16.2.a of Regulation on purchase and sale of debts by credit institutions issued by Decision 59.

83 Decree No. 05/2010/ND-CP dated 18 January 2010.

84 Taking Stock: An Update on Vietnam's Recent Economic Developments, The World Bank, December 7-8, 2010, p. 5

85 SBV Decision 2619/QD-NHNN dated 5 November 2010 on the base interest rate in Vietnamese dong and Decision 271/QD-NHNN dated 17 February 2011.

cent growth experienced during 2009, but in excess of the government's target of 25 per cent. The government has voiced its policy to limit further growth in 2011.

In addition, the foreign exchange market remained highly volatile for the third year, due to short supplies of foreign currency and increased foreign currency lending. The SBV has been compelled to devalue the Vietnamese dong against the dollar four times since November 2009, most recently in February 2011.[86]

In response to the instability of gold markets and the weakening Vietnamese dong, the Vietnamese Government closed gold trading floors nationwide as of 30 March, 2010 and the SBV requested that all gold trading on off-shore accounts should cease by 30 June, 2010[87]. In October 2010, the SBV also limited the retention and use of gold deposits by commercial banks.[88]

Against this background, the adoption in June 2010 by the National Assembly of the revised SBV Law and the LCI was the most significant banking regulatory development last year. The SBV Law is expected to improve the accountability and authority of the SBV in its capacity as central bank of Vietnam by increasing its accessibility and autonomy in relation to the utilisation of monetary policy tools, including interest rates and foreign currency reserves, and the supervision of the banking sector. The LCI, which contains detailed provisions relating to the organisation and management of credit institutions and more effectively addresses the practicalities of the banking business, is designed to enhance the autonomy, safety and soundness of credit institutions, as well as transparency.

The removal of the interest rate caps and the issuance of Circular 13 (replacing Decision 457) on prudential ratios in 2010 are expected to have a significant impact on the operation of the credit institutions. On the one hand, credit institutions have greater flexibility in setting interest rates, but, on the other, they are now subject to tighter prudential ratios while facing stricter requirements on the amount of funds eligible for lending activities. Although the SBV frequently makes declarations to the commercial banking sector urging restraint on the application of high interest rates, the hope is that the provisions of Circular 13 will allow Vietnamese banks to price risk more effectively and make credit available to smaller companies whose risk profiles would not have supported a lower prescribed rate.

Other regulatory highlights include a new solvency ratio and additional corporate governance requirements for banks (see Section III, *supra*), the extension of specific bankruptcy procedures to commercial banks and the formalisation of SBV powers to place banks under special control, and the establishment of regulations to

86 An effective devaluation of 9.3 per cent in February 2011 following official depreciations of 3.36 per cent in February 2010, 2.1 per cent in mid-August 2010 and 5.44 per cent in November 2009.

87 SBV Circular No. 10/2010/TT-NHNN dated 26 March 2010 amending Articles 2.2 and 2.3 of Circular No. 01/2010/TT-NHNN dated 6 January 2010 which repealed Decision No. 03/2006/QD-NHNN dated 18 January 2006 on gold trading on offshore accounts and Decision No. 11/2007/QD-NHNN dated 15 March 2007.

88 SBV Circular No. 22/2010/TT-NHNN dated 29 October 2010.

govern the merger, consolidation and acquisition of credit institutions (see Section VI, *supra*).

VIII OUTLOOK AND CONCLUSIONS

At a macro level, it is expected that the SBV will use the intervention powers confirmed in the new SBV Law to continue to tighten monetary policy and intervene in foreign currency matters. It has called for a ban on all gold bars trading in Vietnam in the second half of 2011.

In the banking sector, a number of important changes in the policies and regulations implemented in 2010 are expected to fundamentally reshape the working environment. The profitability of commercial banks may suffer in 2011 as they struggle to meet the current capital adequacy requirements (up from 8 to 9 per cent) effective since October 2010.[89] It is also expected that the current fierce competition among banks for fund mobilisation, resulting in the increase of deposit interest rates, will affect profitability. The requirement for joint stock banks to increase their minimum charter capital to 3,000 billion Vietnamese dong by 31 December 2011(an increase from 1,000 billion Vietnamese dong in 2009),[90] may result in some consolidation of the private bank sector as smaller undercapitalised banks find themselves unable to mobilise the required equity.

From a regulatory perspective, the emphasis will be on the issuance of implementing guidelines for the two new banking laws (the SBV Law and the LCI) to create a solid and consistent legal framework for banking activities, although concerns remain over practical monitoring and enforcement at the initial stages.

A new Circular (expected to be issued in early 2011), replacing the current Decision 493 on loan classification and provisioning, is expected to bring Vietnam's practice closer to internationally recognised standards and should provide a more accurate reflection of the quality of the bank portfolios. With tighter loan classification, resulting in higher reported NPL ratio and provisioning, credit institutions will also face greater challenges in meeting the CAR, among other requirements. However, while the revised regulations might adversely affect the profitability of the banking sector in the short run, they are expected to contribute to the safety, stability and reliability of the financial sector in the medium-term.

It is also anticipated that the SBV will also introduce measures to promote non-cash payments (bank cards, cheques, bank transfers) in Vietnam during the period from 2011 to 2015.

In terms of policy, the hope is that Vietnam will continue to move towards the strengthening and reorganisation of credit institutions in line with international standards and increased transparency of banking operations. There is a clear need for the continuing development and refinement of regulations relating to more sophisticated offerings, such as derivatives (including with respect to confirming the enforceability of set-off).

89 Cf. Section III (Prudential Regulation).

90 Decree 10/2011/ND-CP dated 26 January 2011 amending Decree 141/2006 dated 22 November 2006 on banks' charter capital.

Appendix 1

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Samantha Campbell is an English-qualified solicitor. She is the resident partner heading Gide Loyrette Nouel's ('GLN') practice in Vietnam and shares her time between GLN's offices in Hanoi and Ho Chi Minh City. Before joining GLN in Vietnam in 2009, Samantha was at a top-tier US law firm in London for nine years, prior to which she practised at a leading English law firm.

Ms Campbell's experience includes advising on numerous international finance transactions, including general bank lending work (secured and unsecured), capital markets issuances, asset-based financings, acquisition financings and debt restructurings. Her practice has an emphasis on highly structured project development and financing matters including the negotiation of project documents with host governments, state-owned companies and other counterparties. Her work to date has involved transactions around the world in both developed and emerging economies, including in Asia, the CIS, sub-Saharan Africa, Europe and South America.

In Vietnam, Ms Campbell regularly advises international banking clients on the regulatory framework applicable to their activities, including in developing sectors such as consumer financing and derivatives. She also represents international lenders in connection with financing the activities of Vietnamese institutions.

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Pham Bach Duong specialises in banking and finance law and compliance in Vietnam and South-East Asia.

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