Vietnam

Financial Sector Diagnostic

2008

International Finance Corporation
World Bank Group

Vietnam

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Introduction

Macroeconomic Context

Although economic growth (GDP) remained strong at 8.5% in 2007 (see Table 1), the economy still faces a number of challenging policy issues for 2008-09. Real GDP growth slowed in the first quarter of 2008, dipping to 7.4% year-on-year (yoy). Inflation has continued to accelerate, soaring to 25% yoy in May 2008. The government has tightened monetary policy to achieve economic stability by increasing the reserve requirement (from 10% to 11%), forcing banks to buy VND20.3 trillion (US$ 1.26 billion) treasury bills, and setting a limit for loan growth rate of 30% in 2008. Stock markets continued to fall sharply since beginning 2008, with VN-Index down to approximately 400 points (compared with over 1,100 in March 2007), and low liquidity. The current account will remain in deficit in 2008, estimated at 20% of GDP due to fast pace of import growth; while exports grew 27% in Jan-May, imports rose 70% led by steel, gold, autos, refined petroleum and machinery. The exchange rate is unstable, with the dong (VND) depreciating by over 15% in June (from VND 16,000 to 18,500 in free market), then recovering in July, 2008. Gasoline and oil prices increased approximately 30% in July 2008.

The rapid increase in property prices in 2007 has led to a real estate bubble. In order to prevent the property sector from overheating, the government introduced a capital gain tax on property transactions (applicable from Jan 2009) in Nov 2007 and is discussing a punishment tax for holding more than one property. The government has also instructed property developers not to sell apartments before the base of the building has been completed. Other regulations and issues being discussed include a lending limit to the property sector, a limited land fund in the central area, high land prices, poor infrastructure and difficulties in accessing real estate projects. The prices of properties in Ho Chi Minh City and Hanoi decreased by 50 - 60%, and 20 - 30%, respectively by the end Quarter 2 of 2008, without any sign of recovery. Expectations are that late 2008, when mortgage loans signed at the peak of housing bubble come due, banks will have to foreclose mortgaged houses. They will also face the dual challenges of a lack of liquidity in the real estate market, and the collection of foreclosed collateral.

Table 1	2004	2005	2006	2007
GDP (current Million US$)	45,210	52,408	60,850	71,465
GDP growth (annual %)	7.7	8.4	8.2	8.5
Real GDP per capital (US$)	556	638	725	839
Inflation, GDP deflator (annual %)	7.9	8.4	6.6	12.6
Exchange rate (VND:US$)	15,676	15,817	15,964	16,114
Agriculture, value added (% of GDP)	21.76	20.89	20.4	20.25
Industry, value added (% of GDP)	40.09	41.03	41.52	41.61
Services, etc., value added (% of GDP)	38.15	38.07	38.08	38.14
% Poor households (national line)	23	22	18	15

Source: World Bank & Ministry of Planning & Investment; Economist Intelligence Unit (EIU) and Government Statistic Office.

In March 2008, Vietnam's Fitch sovereign rating remained at BB- (similar to Indonesia and Sri Lanka), whereas other countries that had the same rating have improved

(Thailand (BBB+), India (BBB)). In April 2008, Moody's Ba2 rating on foreign currency, went unchanged from 2007. Although S&P rating is still BB+ (local currency), and BB for foreign currency in May 2008, the status has changed from stable to negative.

Government Priorities

Government gives high priority to controlling inflation and achieving macroeconomic stability. In order to combat the sharp increase in inflation (25% in May 2008), various interventions by the State Bank of Vietnam (SBV) during the first five months of 2008 to slow credit growth included hiking deposit reserve requirement to 11% (from 10%) and interest rates where the refinancing rate went up to 13% and the discount rate to 11% (from 6.5% and 4.5%, respectively in 2007). To reduce money supply, following its decision to raise the reserve requirement ratio by 1% (to 11%), and the SBV requested that 41 commercial banks purchase VND20.3 trillion (US$ 1.26 billion) in T-bills on 17 March 2008. The government has decided to rein in its own spending, and at the same time put other large spending projects on hold.

Demand for Financial Services

Vietnam's demand for financial services difficult to gauge due to traditional family-centered business behavior**.**

In general, the country's finance sector is characterized by a low penetration rate[1]. Out of a total population of 84 million, less than 10% are estimated to be using bank services regularly, and only around 8.2 million people have bank accounts. By the end of 2007, there were six million ATM cards from personal bank accounts issued on 4,500 ATM machines; 64% of these machines were located in HCM city and Hanoi. The SBV expects the number of ATMs to increase to 6,900 by end of 2008.

The low penetration rate should mean significant long term growth potential for commercial banks. With the country's economic growth reflected in expenditure and wealth increase, nominal GDP per capita for households has grown from US$ 355 in 1998 to US$ 556 in 2004 and US$ 839 in 2007.

Private Sector/SMEs

The private sector continues to gain importance in the economy.

In 2007, only 116 SOEs were equitized - or 21% of the original 600 SOE target. With an estimated contribution of 35% to GDP, SOEs represent one-third of the economic power of the country. In aggregate, at the end of 2007, approximately 3,000 enterprises remained fully or partially state-owned, with 3,800 SOEs equitized[2]. Once equitized, SOEs are then transferred to the management of the centralized State Capital Investment Corporation (SCIC) which will retain some 100-200 strategic companies and divest the rest.

The private sector now consists of an estimated 250,000 enterprises and 3 million family-run businesses (defined as having up to 299 employees). Of these, nearly 70% are involved in the trade and services sector, with the remaining 30% involved in manufacturing/industry. The majority of these family run enterprises are not registered. In 2007, the private sector contributed about 45% to the GDP and accounted for about 90% of the national employment.

The July 2007 Enterprise Law facilitates the development of private enterprises by further simplifying administrative procedures for doing business and establishing a more 'level playing field' for all enterprises. According to the Ministry for Planning and Investment (MPI), 58,916 new enterprises were registered in 2007, with VND 489 trillion (US$ 30.65 billion) in registered capital (2006: 46,000 enterprises with VND 148 trillion (US$ 9.25 billion)). In 2007, the domestic private sector accounted for 40.7% of

[1] In 2007, there were only 8.2 million bank accounts in Vietnam out of a population of 85 million, five million of them for individuals, which amounted to a penetration rate of 10%. The figures for 2006 are 6 million individual accounts.

[2] Equitization is the conversion of a state-owned company into a joint-stock or limited liability company, with the majority (if not all of the stocks/ shares) retained by the state.

aggregate investments (34% in 2006), and posted a second straight year of industrial production value growth over 20% (21% in 2007, 22% in 2006).

The overall size, sophistication, and number of enterprises is increasing - as is their need for greater access to finance. The World Bank Investment Climate Survey indicates access to finance to be a more significant constraint to enterprises in Vietnam than to those in other countries. Small and medium sized enterprises (SMEs) in Vietnam are not able to easily access financial services and secure financing, due mainly to a strong risk-adverse bias on the part of banks with respect to SME lending and the absence of a diversified financial sector capable of servicing SMEs (especially a lack of specialized financial institutions to provide loans for SMEs).

According to statistics, new credits in 2007 accounted for 22% of GDP, while new investments stood at 40.4% of GDP. Banks are meeting approximately half of the financing needs for investment, with most available loans in the market being short to medium term, as banks generally lack access to long-term capital.

The government's attempt to control inflation through tightened credit policy means that SMEs, and other enterprises will face more difficulties in accessing finance.

Financial Sector Overview

The Vietnamese financial sector is still less liquid than some of its regional counterparts, with nearly all deposits soaked up by loans. The loan/deposit ratio in Vietnam is now 95%, much higher than the average ratio in Asia of approximately 80%. Loans have grown faster than deposits over the past several years, as shown in Table 2, with exception of 2006, when loan-growth slowed as a result of the boom in the formal and informal stock markets prompting businesses to raise cheaper finances through equity offerings.

Steady loan growth in 2007 resulted in a credit balance of 93% of GDP - much higher than the 80% average seen across Southeast Asia.

Table 2	2004	2005	2006	2007
Total loans in million US$	26,795	34,969	43,462	66,261
% loan growth	42	32	25	54
Loans as % of GDP	59	67	71	93
Total deposits in million US$	28,205	36,839	49,905	69,984
% deposit growth	33	32	37	42
Deposits as % of GDP	62	70	82	98
Loans as % of deposits	95	95	87	95

Source: World Bank and BV

Vietnam's transformation to a market economy, particularly since 1998, has resulted in a more diversified banking system, in which state-owned banks, joint-stock, joint venture, and foreign banks serve a broad customer base. Table 3 shows the evolution of the number of each type of financial intermediary over the past few years.

Banks are, however, hampered by insufficient capital, limited operational scale, and high credit risk. Lending prioritizes SOEs and overwhelmingly relies on fixed assets (land and property) for collateral.

Financial Institutions

Table 3	2004	2005	2006	May 2008
Number of Banks	69	71	78	86
*Joint-stock Banks**	*36*	*35*	*34*	*36*
Foreign Banks	*28*	*30*	*31*	*37*
State-owned Commercial Banks	*5*	*5*	*5*	*5*
Joint Venture Banks	*n.a.*	*n.a.*	*6*	*6*
Development Bank and Policy Bank	*n.a.*	*1*	*2*	*2*
People's Credit Funds	900	900	926	998
Total	1,088	1,102	1,152	1,170

Source: SBV

Two joint stock banks were officially established in early 2008. Other banks accepted in principle are Bao Viet, PVFC, FPT, Energy (Nang luong), Asia Foreign Trade (Ngoai thuong chau A), Vietnam Star (Ngoi sao Vietnam), Indochina Trade (Dong Duong Thuong tin), and Bao Tin.

SOCBs

After a long wait, the Bank for Foreign Trade of Vietnam (VCB) completed the equitization of 6.5% of its capital in 2007, with an average price of VND 107,000 (or US$ 6.7) per share and the official announcement of operation as a joint-stock bank in May 2008[3]. However, VCB was not able to negotiate with strategic partner(s) before being publicly auctioned because of proposing relatively high prices. The other SOCBs (including MHB, BIDV, Vietinbank) are scheduled to be equitized in 2008 and 2009, in order to address commercialization, capital, asset quality and financial reporting/transparency issues.

The five state-owned commercial banks (SOCBs) (listed in Table 6 below) together operate more than 3,800 branches and transaction centers. These SOCBs account for 54% and 59% of the market share of loans and deposits, respectively, which were basically unchanged from 2006 levels.

Historically, the SOCBs have been an instrument of policy lending, with lending influenced by social or political objectives rather than commercial considerations. Each bank has traditionally focused on a certain industry segment (as indicated by their names). This often includes policy-directed lending programs with a focus on SOEs.

SOCBs are still the main source of funding for SOEs, many of which are inefficient and uncompetitive by international standards. Already heavily exposed to these enterprises, the SOCBs often have no alternative but to continue their support. More positively, the immense branch network and good reputation with domestic depositors give SOCBs a strong competitive edge over private institutions. Subsidized lending and government-backed positions enable them to attract a large customer base. On the down side, they are prone to government intervention, appear overstaffed, and seem to be administrated rather than managed.

Banks used to publicly announce information on net income, total customer deposits and loans on a monthly basis. However, banks are now reluctant to disclose pretax profit, and only tend to emphasize good liquidity and mobilization of capital.

Joint Stock Banks

Joint-stock banks (JSBs) have a relatively short history of less than 15 years of operation in Vietnam. However, their dynamic and innovative business and management mindset, is putting great competitive pressure on the SOCBs and foreign banks.

[3] For this diagnostic report, VCB's is considered one of the five SOCBs

There are 37 joint-stock commercial banks in Vietnam, operating mostly in the country's main urban areas. According to JSB summary in table 8, impaired loans of joint commercial stock banks stood at approximately 1% under VAS (3% in 2006) and their average CAR of over 20% by the end of 2007. Deposit and loan growth of JSBs were approximately 97% and 170% in 2007, respectively.

The Asian Development Bank splits the joint-stock banks into three subgroups:

- Five larger urban banks comprising Techcombank, Saigon Thuong Tin Commercial Joint Stock Bank (or Sacombank, rated 'D' by Fitch), the Vietnam International Bank, (ACB, rated 'D') and the East Asia Commercial Bank.
- About nineteen smaller banks, which are growing rapidly or have established a niche market (including Hanoi Building Commercial JSB and Viet A Commercial JSB);
- Twelve previously small rural joint-stock banks, eleven of which have transformed into urban JSBs in 2007 and opened branches - a reflection of their widening business. These relatively small banks have private majority shareholdings, with registered capital per bank varying between US$ 40-500 million at the end of 2007.

JSBs are also gaining in stature from the public/customers. JSB's market share has grown to 17.6% in Hanoi and 38% in Ho Chi Minh city compared to the SOCBs' 59% and 35.5% in 2007[4]. ACB and Sacombank's net profits increase led the market in 2007 with 197% and 248%, respectively. Loan growth is also impressive, at 87% and 146% for ACB and Sacombank, respectively.

In 2007, JSBs actively increased their capital to boost their competitiveness by 94.6% in Ho Chi Minh City, and 75% in Hanoi. This sharp increase is now causing a corresponding pressure from shareholders to generate profits. The JSBs' network expansion was fast; some banks now have as many as 150 branches/transaction offices, but mainly in urban areas.

In general, banking products are unsophisticated and lack any real diversification across the sector. Many product areas are also underdeveloped (e.g. mortgage finance). However, some banks have begun to specialize and innovate with services such as foreign exchange transactions and export-import finance, including letters of credit (Eximbank and East-Asia Bank), mobile banking services (Sacombank, ACB and Techcombank), derivate trading, options to minimize commodity pricing risks (Eximbank and Techcombank), security and leasing subsidiaries.

While most JSBs and SOCBs provide only basic trade finance services (LCs), factoring services are currently available at 11 local banks (including VCB, ACB, Sacombank, and Techcombank), and certain foreign bank branches.

JSBs are striving to become leading retail or universal banks by providing every banking product to every market segment. They all offer foreign exchange services, with some restrictions on the differential they can charge relative to the officially set rate (margin of 2% vs Interbank rate).

In many JSBs, management information systems (MIS) are not well developed. Even basic client information (number of accounts per client, types of services sold to one client, etc.) is often not retrievable. The leading JSBs only recently acquired modern core banking systems.

Although difficult to measure and compare, business skills appear to be better developed in JSBs, where staff are generally more client-focused and market-oriented than in the SOCBs. JSB staff members are often trained in-house and on-the-job through interaction with the clients. In addition, they are motivated by attractive performance-based packages.

The stock market has dramatically decreased since early 2008. As a result, the prices of "king shares" (a term used for bank shares) on the official stock market also fell

[4] Vietnam Economic Times

down. The OTC market also experience share prices of banks are normally at par value, and lack of liquidity.

While domestic investors are trying to bargain bank shares, foreign institutions are still interested and are seeking to raise their ownership in Vietnamese lenders.

In July 2008, the Standard Chartered Bank raised its ownership in Asia Commercial Joint Stock Bank (ACB) from 9% to 15% by buying shares from IFC. OCBC, the third-biggest finance group in Singapore, has also reached a deal to increase its holdings in VP Bank from 10% to 15%. Hong Kong and Shanghai Banking Corporation (HSBC), which recently boosted its stake in Techcombank from 10% to 15%, has apparently reached a preliminary agreement to raise their ownership to 20%. Meanwhile, May bank has reached a strategic cooperative agreement to buy 15% shares of An Binh Bank. BNP Paribas has bought 10% stake of Oriental Commercial Bank, and UOB has bought the same portion of Southern Bank.

Table 4 below summarizes foreign partners' investment in local JSBs 31 December 2007.

Table 4	% Stake of Foreign Partners in JSBs		
Joint-Stock Banks	**Foreign Bank**	**2006**	**2007**
ACB	Standard Chartered Bank	8.56%	8.56%
	Connaught Investors Ltd	7.30%	7.30%
	Dragon Financial Holdings Ltd	6.84%	6.84%
	IFC	7.30%	7.30%
Sacombank	ANZ	9.87%	9.83%
	Dragon Financial Holdings Ltd	8.77%	8.73%
	IFC	7.66%	7.63%
Techcombank	HSBC	10.00%	15.00%
VP Bank	OCBC	10.00%	15.00%
Southern Bank	United Oversea Bank	10.00%	10.00%
Habubank	Deutsch Bank	10.00%	10.00%
East Asia Bank	Citibank**	10.00%	10.00%
Exim Bank	SMBC	0.00%	15.00%
	Other investment funds		10.00%

Sources: annual reports and media

Potential international investors in JSBs need to be among the top 500 banks in the world. In 2007, the SBV has raised the foreign ownership stake threshold from 10% to 15% of total chartered capital of one Vietnamese bank (and up to 20% with government permission in case the investor is considered a strategic partner). Total shares owned by international investors may not exceed 30%. This process is lengthy and investors are restricted in share transfers for a number of years after such an investment.

Foreign Banks

Foreign banks account for 13% of deposits in 2007 (increased from only 8% in 2006). Loans outstanding were decreased slightly from 10% to 8% while SOCBs and JSBs both increased loans. This, however, showed the fact that foreign banks are more prudent in term of loan management.

Vietnam also has a number of foreign banks (with a total of 37 branches and 53 representative offices), and six joint-venture banks. Foreign Banks focus their services entirely on serving foreign-invested companies, large state-owned corporations, and foreign individuals in country. Some (Citibank, ANZ, and HSBC) also target wealthy Vietnamese clients. Foreign banks have been instrumental in introducing new products to the Vietnamese market (e.g., mortgage services (ANZ) and medium-term certificates of deposit (HSBC)). At the same time, they have also penetrated the retail market through automobile and housing loans, and international credit card services.

In direct contrast to the limited inquiry function of internet services offered by some larger SOCBs, foreign banks like Citibank, ANZ, and HSBC offer a full range of internet banking services. Citibank and HSBC are also growing their investment banking activities.

Market share expansion of foreign banks has not been impressive as it was with the JSBs. Large banks, such as HSBC, Citigroup, Deutsche Bank, and ANZ, have widened their presence by buying stakes in local joint-stock players.

In line with WTO commitments, however, Vietnam's banking sector is gradually opening up to foreign banks. The SBV has recently approved in principal the establishment of three 100% foreign-owned banks, HSBC, Standard Chartered Bank and ANZ.

Microfinance

Microfinance in Vietnam is not well established as a sustainable financial service business approach targeting the poorest segment of society. There is no sector strategy and the industry is not well integrated in the larger financial sector. Moreover, the quality of the services and the range of products provided reflect a somewhat immature market. There is still a widespread tendency to see microfinance as a social tool to combat poverty, and micro-credit as a policy lending instrument that needs to be supported by subsidies. This creates a number of policy distortions, problems in the legal and regulatory framework, and institutional weakness.

Microfinance comprises three types of institutions: formal, semi-formal and informal. The formal institutions are the Vietnam Bank for Agriculture and Rural Development (VBARD), the Vietnam Bank for Social Policies (VBSP) and the People's Credit Fund (PCFs), which provides finance to up to 80% of the poor in Vietnam. The semi-formal sector includes government organizations and international NGOs. By the end of 2006, an estimated 57 semi-formal and informal organizations served some 164,000 clients in 547 communes and represented about 7% of the microfinance market. The informal sector, consisting of money lenders, friends and relatives, is estimated to supply 50% of total credit needs among poor and low income people.

Leasing Companies

There are currently 13 leasing companies operating in Vietnam (the newest is Vinashin financial leasing company limited, established in 2008), of which seven are subsidiaries of the SOCBs. The average capital of a finance leasing company is VND150billion (US$ 9.37m) - very small when compared to the chartered capital of commercial banks, at over VND1trillion (US$ 62.5m). All leasing companies fall under the supervision of the State Bank of Vietnam (SBV). Apart from the Law on State Banks of Vietnam (LSBV) and the Law on Credit Institutions (LCI), the leasing industry is regulated by a number of decrees specifying the rights and obligations under leasing contracts, the sale of leasing contracts, the lessor's right to recover assets in the event of early termination of a lease, and the re-lease or re-sale of such assets. The absence of an agency or trust law may cause problems in defining fiduciary duties of the lessee following the sale of receivables with recourse.

Leasing	2004	2005	2006	2007
Outstanding (VND billion)	6,427	7,700	8,700	12,000
Outstanding (USD million)	402	481	544	750
% of GDP	0.91	0.93	0.90	1.05

Sources: Leasing

Association

Activity in the leasing market is relatively limited, with total outstanding not more than 1% of GDP, partially due to a lack of public awareness, high leasing fees, and lack of regulation in the finance leasing market. Limited activity may also be attributed to a misconception of the instrument by supervisors, lessors and lessees, all of whom treat leasing like a sub-form of the standard collateralized lending common in Vietnam. Furthermore, there are no special tax incentives for lessors or lessees.

ADB has provided support in the area of financial and legal policy reform, and is presently formulating the sub-sovereign/private sector investment project, in order to support the development of the leasing industry in Vietnam. The government has agreed to a US$ 20 million Ordinary Capital Resources Leasing Investment Loan during the 2006 Country Programming Mission; the loan is listed in the 2007-2010 CSP. The Financial Sector Program Loan II (FSPL II) developed the initial legal and regulatory guidelines for the operation of financial leasing companies, and the SME Sector Development Program Loan (SDPL) formulated the concept of the Leasing Investment Loan to facilitate SME access to finance.

Insurance Companies

Vietnam has actively developed its insurance industry. By the end of 2007, Vietnam housed 41 insurance companies, including 23 non-life, nine life, one reinsurance and eight insurance brokerage firms. The Insurance Law, enacted in April 2001, allows foreign joint ventures and foreign-owned subsidiary branches to operate in Vietnam. All of the state-owned insurers (Bao Minh, Vinare, and Bao Viet) have been equitized. Bao Viet (65.34% state owned), the number two life insurer after Prudential (in terms of life insurance premium) boasted a market share of 35% in 2007, down slightly from 2006's 36.5%, and trailing Prudential's 42% market share. For non-life insurance, Bao Viet and Bao Minh together account for 60% of market share, with PVI accounting for 20%.

Vietnam's insurance industry has experienced steady growth recently with an insurance revenue growth rate of over 20% per annum. In 2007 alone, Vietnam insurance revenue was US$ 1.3 billion, representing 1.8% of GDP. Insurance companies have invested US$ 2.5 billion or 3.7% of GDP into the national economy, mostly in medium and long term investments.

Despite significant growth, Vietnam still had one of the lowest density rates (total premiums per capita) and penetration rates (total premiums as percentage of GDP) in Asia in 2007 at,US$ 15 versus the Asia average of US$ 198. Penetration rates (total premiums as percentage of GDP) were also low, at 2% versus the Asia average of 6.8%. Government aims to increase insurance penetration to 4% GDP by 2010, but there are several impediments to this ambitious target, including:

- Lack of good quality, high-yield, long term investments in local currency. The life insurance industry in particular is affected by the underdevelopment of the country's capital markets, the volatility in bond markets, and the unstable real estate market.
- Limited availability of products, as outreach is currently bound to urban areas (for both life and non-life) and corporate customers (for non-life).
- Lack of corporate governance, management skill, and the technology for local players to be competitive, resulting in missed opportunities for various insurance products, particularly import and export insurance.
- Limited consumer understanding of products, especially non-life insurance products. Compulsory insurance such as for motor vehicles, and fire and explosion insurance is still low at 33% and 40%, respectively. The low rate of insurance also can be seen in other sectors, such as import /export, medical, and agriculture.
- Increased competition from more local insurance companies. By the end of 2007, many companies only reached break even (no profit) due to increase in compensation rate and operating expenses, and reduced insurance fees. Dividends paid to shareholders came from financial investments rather than insurance activities.

The current legislation leaves insurance companies somewhat restricted in their investment options. As stipulated in article 13, Decree 43 dated 1 August 2001, life insurance companies can only have a maximum of 50% of idle capital in statutory technical reserves in unsecured corporate bonds and shares, and a maximum of 40% in real estate business, lending, and authorized investments through financial-credit institutions. The limits are 35% and 20%, respectively, for non-life insurance companies.

Pension Funds

The pension fund industry lags behind, with one state-managed pension fund (the State social insurance fund). This State social insurance fund lends to the SBV and Development Investment Bank for policy loans and invests in bonds, treasury bills, bank bonds and bank deposits. The government has recently approved a decision to implement a voluntary pension plan for workers in the informal sector, in addition to strengthening the current pension plan.

The first ever Social Insurance Law was passed in 2006 and will be implemented between 2007 and 2009. The reform aims to gradually expand the coverage of the system and to ensure its financial sustainability. The Social Insurance Law of 2006 introduced a voluntary old-age pension program accessible to any working-age person not currently enrolled in the compulsory program. The features of the voluntary program are largely inspired from the compulsory system. Mandatory contributions for participation must be at least equal to 16% of the minimum wage Pension benefit entitlement occurs at age 55 for women and 60 for men, after a minimum of 20 years of contribution. Immediate relatives are entitled to a survivor pension. The main differences with the compulsory program are the absence of a ceiling on contributions and the absence of a minimum pension.

In 2007, total worker contributions to social and health insurance funds reached 37.85 million people, of which, compulsory insurance was 7.99 million people, an increase of 18.5% over 2006. Private, foreign, and military sectors accounted for the majority of the increase due to the issuance of the Decree No. 68/2007/ND-CP dated 19 April 2007. Total receipts in 2007 reached approximately VND 30 trillion (US$ 1.87 billion), an increase of 26.4% yoy, exceeding the Prime Minister's 5.1% increase benchmark, with compulsory social insurance totaling VND 29 trillion (US$ 1.81 billion), and voluntary health insurance totaling VND 814 billion (US$ 50.87 million). Total payment from the social insurance fund was VND 42 trillion (US$ 2.62 billion), an increase of 27.7% yoy.

Other NBFIs

In addition to banking, leasing, and insurance companies, Vietnam has 10 financial companies, 30 management funds, and 69 securities companies (out of 80 companies licensed with the Vietnamese State Security Commission) operating in the market as of May 2008.

In August 2006, the SCIC was incorporated as a specialized financial company. The SCIC acts as a holding company for all state assets, mandated with their management and equitization. SCIC has an important role in Vietnam's capital market in terms of supplying equitized SOEs to the stock market. It may also engage in direct and capital market investments. The SCIC must maximize return on state capital.

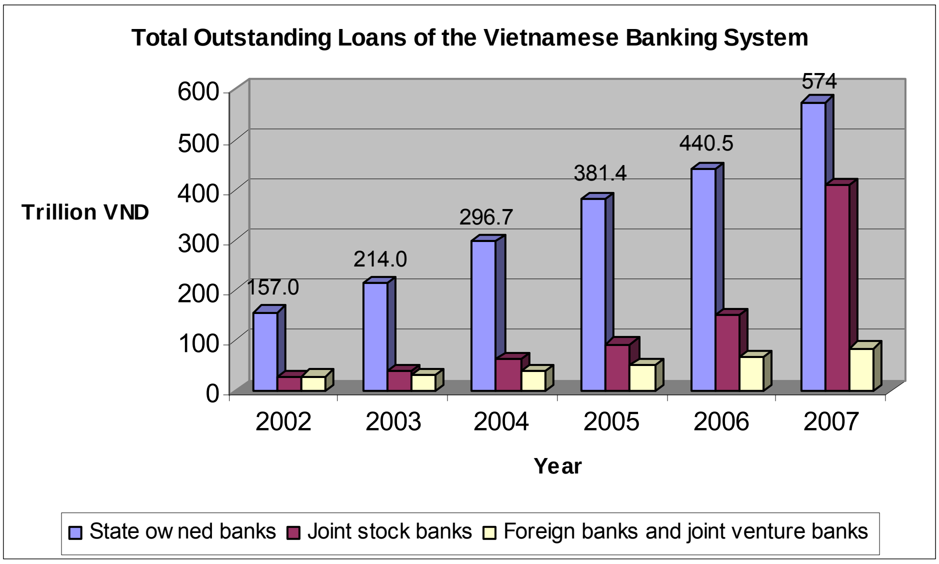
Market Structure

Assets

The total banking sector asset base stood at VND 1,872 trillion (US$ 117 billion) at the end of 2007, with the SOCBs controlling the bulk of assets in the financial system (48% compared with 67% in 2006). The JSB's market share has seen rapid growth and now stands at approximately 48% of total assets (from 25% in 2006), although risk management is highly uneven and these figures may overestimate actual market share. Total assets of foreign banks have grown to approximately 11% of the total banking sector.

At the end of 2007, outstanding loans were at approximately VND 1,068 trillion (US$ 67 billion). The greatest growth of loan market shares belonged to JSBs, reaching 38% from 23% in 2006, mostly by taking SOCBs' portion which experienced 13% lost in 2007 (see Figure 1).

Figure 1



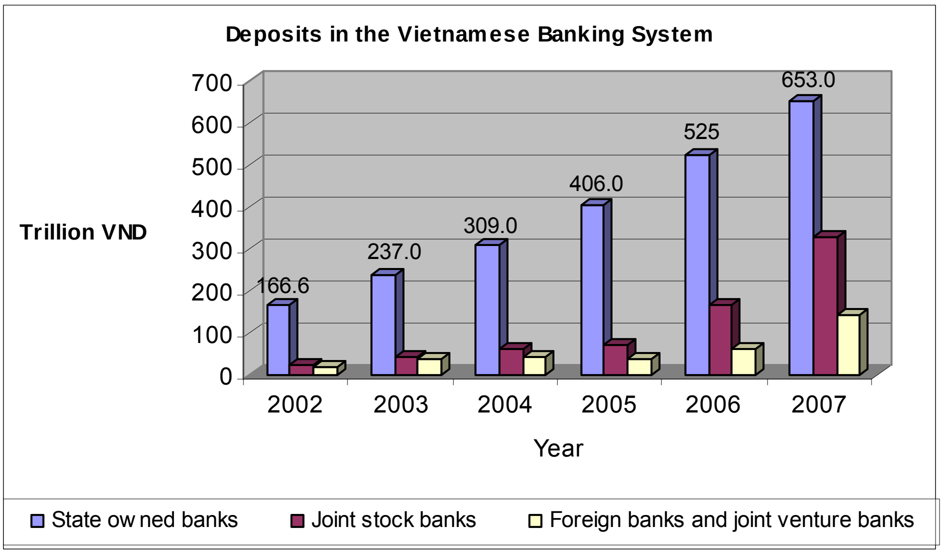
Source: SBV

Liabilities

In 2007, SOCBs held 58% of all liabilities in the market. Although SOCBs still have the ability to collect short-term and long-term deposits nationwide due to their extensive branch network and positive image, the proportion has decreased rapidly from 70% in 2006.

JSBs are increasing their drive for deposit mobilization (from 22% to 29% in 2007) and have developed a number of products to attract savings, targeting Vietnamese individuals to increase deposit mobilization. Meanwhile, foreign banks also reached 13% (from 8% in 2006) as they are allowed to mobilize local currency (VND) since 2007 (see Figure 2).

Figure 2



Source: SBV

Performance

According to data from the State Bank of Vietnam (SBV), the banking sector has seen an improvement in performance since 2006. In 2007, total non-performing loans (NPLs)/loans ratio of the entire banking sector were reduced to approximately 1.5% (2006: 3%), mostly due to the increase in loan growth. Sector average return on assets (ROAA) and return on equity (ROAE) was approximately 1.9%, and 17%, respectively which are both higher than SOCBs'. Average capital adequacy ratios (CAR) of banks were over the required rate of 8% while SOCBs' CARs were smaller than JSBs and foreign banks'.

This financial data was in accordance with Vietnamese Accounting Standards (VAS) which still has big gaps compared with International Financial Reporting Standards (IFRS). The audited reports are usually qualified under IFRS (but unqualified under VAS), which could mean that the actual profitability or ratios could be lower than stated.

For 2008, Vietnam's commercial banks face a particularly challenging environment. Banks were instructed to be more cautious in lending for share purchases and real estate trading as the government has tightened loan growth rates to 30%, and 3% of total portfolio for securities lending.

Most banks are now competing for liquidity by increasing deposit rates (17-18% per year in June, 2008) after the central bank lifted a 12% ceiling on interest rates. The ceiling lending rate will therefore be 21% per year (from 18%). This is likely to result in borrower stress and higher credit costs. In this regard, the private banks are most exposed, given their rapid loan growth over recent years, particularly to property investors, who have seen stock and property prices fall in 2008 after rising rapidly in 2007. Whether the smaller private banks have been more prudent is unclear, due to limited transparency - which is also a concern, given that the regulatory and supervisory regime is not strong.

Non-performing loans (NPLs)

The true level of non-performing loans in the banking sector is difficult to judge due to a lack of transparency and statistical data as well as gaps in the (VAS) in defining non-performing loans and setting up loan-loss provisions by banks.

Table 5 Overdue and unsettled loans/total loans

Year	SOCBs	Social policy bank & MHB	Non-state banks	Total
2004	2.92%	4.92%	1.91%	2.77%
2005	3.81%	3.52%	1.42%	3.17%
2006	3.19%	3.34%	1.29%	2.60%
2007	1.87%	2.20%	0.94%	1.50%

NPLs for SOCBs by the end of 2007 stood at approximately 2% of total loans portfolio (under VAS). During the period of 2001-2003, the government injected a large amount of the state budget to SOEs to enable them to reduce their NPLs. Out of the resolved NPLs from SOEs, 36% was paid out by state budget sources, 40% by risk provision funds, and 24% by the liquidation of assets. It is said that NPLs figures could be about 15% of outstanding loans in the state-owned sector, if international accounting standards are applied.

NPLs for non-state banks (JSBs and foreign banks operating in Vietnam) were at less than 1% of total portfolio. Average NPLs for JSBs were approximately 1% of total outstanding loans whereas ratios for foreign banks were as low as 0.06%.

Article 7 of Decision 493/2005/QĐ-NHNN dated 22 April 2005 of the State Bank of Vietnam requires banks to set up their credit classification system in order to calculate NPLs and loan-loss provisions accordingly. This Article brings VAS closer to IFRS for NPL figures. Banks have been given a grace period of three years to follow this Article, meaning all banks will need to follow this regulation beginning 2008.

It is estimated that under this decision, NPLs/Loans at SOCBs will be approximately 7.7%.

SOCBs Performance

As shown in Figure 1 and Table 6, most SOCBs have experienced rapid loan growth in 2007 over 2006. However, SOCBs are continuously losing market share in loans and deposits, with deposit market share dropping to 58% in 2007 (69% in 2006 and 75% in 2004) and loans decreasing to 54%, from 80% in 2006 and 87% in 2005.

In terms of profitability, only VCB achieved a ROAA of 1.2% which is comparable to average Asian bank ratio of approximately 1.1%. All of SOCBs' ROAE, however, surpassed the average ROE for Asian banks of approximately 11%.

As depicted in Table 5, overdue and unsettled loans of SOCBs are decreasing, yet still remain high compared to other non-state banks. The government has injected capital to clean up bad loans, and increase CARs before the SOCBs are equitized.

By the end of 2007, most SOCBs met the international capital requirements of 8%. However, current CARs for the SOCBs are still much lower, compared unfavorably to regional averages: 13.1% for Asia and the Pacific, and 12.3% for East Asia.

TABLE 6	STATE-OWNED BANKS									
	VCB		BIDV		ICB		VBARD		MHB	
FINANCIAL RATIOS	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007
Growth of Loan Portfolio (%)	11	41.6	15	33.8	7.4	25.0	18.2	33.5	20	37.7
Profitability										
ROAA (%)	1.5	1.2	0.7	0.8	0.5	0.8	0.4	0.6	0.5	0.6
ROAE (%)	21.9	17.9	10.4	16.0	11.3	14.1	9	12.9	8.3	14
Net Interest Margin (%)	2.6	2.3	2.5	2.8	3.0	3.2	4.2	4.4	2.8	2.7
Cost/Income (%)	30.4	30.9	34.5	30.5	46.9	41.6	47.6	42.7	64.9	64.6
Capital Adequacy										
Net Loans / Total Assets (%)	39.8	48.9	61.2	64.5	59.2	60.5	76.5	77	53.3	50.6
Capital Adequacy Ratio (%)	9.6	12	4.8	11.0	6.5	11.6	5	7.2	9.3	9.4
Asset Quality										
Total NPLs (millions USD)	114	n.a	675	358	71	161	224	n.a	n.a.	3
NPL / Gross Loans (%)	2.7	n.a	11.9	4.80	1.4	2.5	1.9	n.a	n.a.	4.7
Reserves / Gross Loan (%)	2.2	2.1	1.5	2.2	0.1	1.7	1.1	1.8	1.4	1.2

Source: Annual Reports, Fitch Ratings, Bank Scope, SBV, Banking Sector Analysis (Bao Viet Securities)

JSB Performance

Tables 7 & 8 show that JSBs are gaining in market share and significant loan growth. Some banks have more the doubled their portfolios. While the loan growth reflects the capture by joint-stock banks of the high growth SME market and the diversification of their lending products, it should be pointed out that part of this loan growth is associated with lending for securities and real estate trading, which is considerably risky and vulnerable to stock market volatility.

Compared to SOCBs, the joint-stock banks were more profitable despite higher costs of funding (higher interest rates for deposits). Average ROEs were 15-20% and average ROAs were 1.9%. Net profits increased significantly - approximately 2.5 times on average from 2006 to 2007. However, a large proportion of these profits was from active participation in the trading of stock securities and real estates which appreciated greatly in the last year, but are declining in 2008. 2007 dividend policy was generous, with approximately 15% - 36% of profits being distributed (ACB: 55% stock dividend). However, given the need for loan-loss provisioning and capital increases, it is debatable whether current levels of profitability are sustainable. It also remains to be seen how joint-stock banks can maintain individual profitability and market share in what is widely considered an oversaturated market that nevertheless continues to expand.

Portfolio quality is good – based on local GAAP – with NPLs reportedly around 1%, down from 3% in 2006. The drop can be mostly explained by loan growth in 2007. However, the accuracy of NPLs is not completely clear. Some banks have very limited

MIS capacities and cannot generate the most basic arrears or default reports. Subsequent risks are limited by the fact that only 53% of total assets are loan assets. The quality of risk management, especially under market stress, is questionable.

Most joint-stock banks have capital adequacy ratios above the hurdle rate of 8%.

TABLE 7	RATIOS (%)											
	Loan Loss Reserve / Gross Loan		ROAA		ROAE		Net Loans / Total Assets		Capital Adequacy Ratio (CAR)		NPL / Gross Loans	
BANKS	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007
Mean	0.81	0.55	1.81	1.90	16.04	16.65	54.31	52.56	26.59	22.98	1.19	0.62
ACB	0.35	0.42	1.47	2.71	33.92	44.26	37.99	37.09	9.97	16.19	0.19	0.08
Sacombank	0.57	0.50	2.40	3.13	19.79	27.36	57.77	54.51	19.94	11.07	0.72	0.23
Eximbank	0.42	0.40	1.74	1.78	18.57	11.24	55.46	54.52	19.09	34.12	0.84	0.88
Techcombank	1.30	0.29	1.84	1.79	18.54	19.12	50.03	51.66	20.00	17.90	3.15	1.35
Military Bank	2.76	1.18	1.94	1.78	21.12	16.55	42.76	36.81	23.13	29.76	0.00	0.00
SCB	0.50	0.41	2.06	1.40	26.13	15.12	76.80	74.78	10.36	13.51	0.83	0.34
SHB	1.25	0.21	0.50	1.62	3.21	17.20	37.18	30.76	34.77	n/a	2.43	1.22
VIB	0.86	0.79	1.21	1.11	20.00	18.32	54.81	42.26	13.06	13.14	2.74	0.56
EAB	0.21	0.36	1.60	1.68	13.00	13.95	66.09	64.71	19.05	14.36	0.77	0.44
Orient Com	0.48	0.56	1.98	1.86	16.65	13.59	72.02	63.93	17.87	21.90	n.a	n.a
SEA Bank	0.27	0.42	1.21	1.64	9.38	13.53	32.88	41.90	31.37	30.49	0.23	0.24
VP Bank	0.22	0.20	1.39	1.61	19.42	15.05	49.27	73.12	16.70	16.41	0.00	0.00
Habubank	1.12	1.42	2.15	2.08	17.20	14.83	50.62	39.48	29.35	33.75	0.00	0.00
Maritimebank	1.28	0.52	0.92	1.33	14.22	12.92	33.46	36.96	10.54	28.86	3.74	2.08
Saigonbank	0.84	0.86	2.23	2.09	15.18	14.47	77.51	71.69	19.37	19.41	0.00	0.48
NamABank	0.32	0.30	1.79	1.64	16.01	11.86	52.55	51.35	29.25	24.68	0.00	0.00
VietABank	0.63	0.36	1.62	2.15	9.89	14.11	64.89	60.66	27.73	23.11	1.94	0.83
HDBank	0.68	0.39	2.16	1.36	14.21	18.82	66.25	64.22	26.44	7.29	0.00	0.30
ABBank	1.24	0.85	3.06	1.60	8.42	9.44	35.87	39.59	105.22	33.54	3.18	1.50
Kien Long Bank	0.90	0.52	2.99	3.57	5.92	11.30	72.07	61.14	48.50	47.19	1.92	1.26

TABLE 8	KEY INDICATORS											
	Total Assets VND billion		Total Equity VND billion		Outstanding Loans VND billion		Growth in Loans %		Total NPLs VND billion		Total Net Profit VND billion	
Banks	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007
ACB	44,645	85,392	1,696	6,257	17,015	31,811	81	87	33	26.5	505	1,760
SACOMBANK	24,776	64,573	2,870	7,350	14,394	35,378	71	146	104	81	470	1,398
Eximbank	18,327	33,710	1,946	6,295	10,207	18,452	59	81	86	162	259	463
Techcombank	17,326	39,542	1,762	3,573	8,696	20,486	64	136	274	277	257	510
Military Bank	13,529	28,005	1,366	3,105	5,906	10,432	37	77	n.a.	n.a.	211	370
SCB	10,931	25,942	794	2,631	8,434	19,478	144	131	70	66	110	259
SHB	1,322	9,288	500	500	493	2,863	n.a.	481	12	35	7	86
VIB	16,527	39,305	1190	2,183	9,137	16,744	73	83	250	94	146	309
EAB	12,040	27,424	1,531	3,229	7,971	17,809	34	123	61	79	160	332
Orient Com	6,441	11,755	833	1,655	4,661	7,557	61	62	n.a.	na	104	169
SEA Bank	10,200	26,241	1055	3,366	3,363	11,041	149	228	7.7	26	99	299
VP Bank	10,111	18,137	836	2,181	4,993	13,287	52	166	29	64	113	227
Habubank	11,685	23,519	1756	3,179	5,983	9,419	80	57	151	n.a.	185	366
Maritimebank	8,521	17,569	795	1,884	2,888	6,528	0	126	108	136	79	173
Saigonbank	6,207	10,184	932	1,432	4,852	7,364	34	52	n.a.	35	117	171
NamABank	3,884	5,240	599	666	2,048	2,699	64	32	n.a.	n.a.	39	75
VietABank	4,181	9,467	756	1,327	2,730	5,764	64	111	53	48	53	147
HDBank	4015	13,823	636	650	2,678	8,912	93	233	9	27	68	121
ABBank	3114	17,174	1132	2,300	1131	6,858	179	506	36	103	58	162
Kien Long Bank	827	2,200	318	638	602	1,352	82	125	12	17	18	54

Source: Annual Reports, Fitch Ratings, Bank Scope, SBV

Financial Infrastructure

Capital Market

Vietnam's equity market has been in a slump for the first 6 months of 2008, with the share price index on the Ho Chi Minh City Stock Exchange (HOSTC) dropping to below 400 points mark (in June 2008) from a high of over 1,100 in March 2007. The country's debt market is still under-developed, though showing signs of improvement.

Vietnam's capital market regulator is the State Security Commission. It supervises Vietnam's two trading centers in Hanoi (HASTC) and in Ho Chi Minh City (HOSTC) and all licensed securities firms. At the end of 2007, a total of 69 securities companies and brokers were operating out of 80 licensed companies (compared with 55 companies by end of 2006). Out of these 69 securities firms, 12 are wholly owned by commercial banks, and one by a state-owned insurance company.

Regulation is based upon the Securities Law enacted on 1 January 2007. The Law represents significant progress towards best practices, regulating the capital market as a whole, and integrating financial services available globally, rather than a narrowly defined securities market. Most importantly, the Law has broadened the definition of "securities" to cover unlisted securities through broadening the definition of the public companies as companies with over 100 external investors (not including professional securities investors and board of management, employees). Furthermore, the securities law raises the minimum requirements for listing from a chartered capital of VND 5 billion (US$ 312,000) to VND 10 billion (US$ 624,000) on the HASTC and VND 80 billion (US$ 5 million) on the HOSTC. While this may standardize listed company size and quality levels, thereby lessening volatility of VN Index, the thresholds prevent SMEs from formal equity financing.

As of May 2008, the HOSTC had 151 listed companies, three securities investment funds, 373 government bonds, and two corporate bonds, for a total capitalization of US$ 14.5 billion (majority in equity and fixed income).

There were 136 companies listed on the HASTC, with a total market capitalization of about VND 70 trillion (US$ 4.4 billion) in equity. So far, 204 government bonds valued at about VND 100 trillion (US$ 6.2 billion) have been listed on the floor. Since 1 July 2006, the government has channeled auctions of Government bonds exclusively through the HASTC and plans to establish an independent bond trading platform at this trading center. The intent is for the Hanoi floor to evolve into the OTC market for Vietnam.

The Ho Chi Minh City Stock Exchange's total annual turnover (trading value) was US$ 10,138 million in 2007, against US$ 1,591 million in 2006 (yoy increase of 537.2%).

Total equity market capitalization in both trading centers rose rapidly from 1.21% of GDP in 2005 to 22.7% and 40% of GDP by the end of 2007 and 2006, respectively. However, market capitalization dropped sharply to approximately 25% of 2007 GDP by May 2008, due to several reasons, including:

Monetary tightening: Banks were instructed to be more cautious in lending for share purchases and real estate trading as the government has tightened loan growth rates to 30%. Fearing a possible bubble in the stock market, the government introduced policies in order to discourage speculative investment and momentum trading by retail investors. In July 2007, the government introduced Instruction 03, which requires the ratio of stock market lending to total outstanding loans in a bank to be capped at 3%.

Other investment sources into stock market, such as repurchases (repo) and collateral, have been blocked because commercial banks do not have available funds.

Surplus of Stock supply: Beginning 2008, a number of listed companies began paying stock dividends. The same situation was observed in unlisted companies OTC market. Stock supply is also increased due to the sales of stock collateral by banks when investors did not meet the margin required as a result of reduction in stock prices.

Lack of foreign buying: Although local retail investors were driving the markets, they actually watched foreign buying patterns for indications to trade shares. The reduced activity by foreign investors somehow discouraged local retail investors from buying shares.

Net foreign purchase of HOSE stocks was US$ 1,430 million in 2007 compared to US$ 401 million in 2006 (yoy increase of 256.6%). During the first quarter of 2008, total turnover was US$ 2,384 million, whereas net foreign buying was US$ 135 million, only one-tenth the level the same period in 2007.

Loss of investor interest due to over-pricing of IPOs: The recent IPOs of the two largest beer makers, Sabeco and Habeco, serve as prime examples of this development. In early 2008, Sabeco (in January) and Habeco (in March), Vietnam's largest and second largest beer makers, were auctioned at the minimum price of VND 70,000, and VND 50,000 respectively. Only 61% and 12.6% of the shares up for auction were sold at the average price of VND 70,003 and 50,015, respectively. The results of these IPOs show less liquidity in the market as compared with early 2007 IPOs.

The credit crunch in the USA: The sub-prime mortgage problems in the US have affected Vietnam both directly and indirectly. First, they directly reduced US demand for goods and services imported from Vietnam. Second, they raised the level of global risk aversion, thereby reducing the level of liquidity in the Asian markets.

Secondary Bond market

The bond market increased to 8% of GDP (US$ 5.1 billion) by the end of 2007, up from only 1% in 2006. Although the listed corporate bond markets are still small, total issuance has reached almost 5% of total GDP by end of 2007. All corporate bonds are issued by large state corporation, commercial banks, or private corporations that have recently built up their brand names in the stock market (listed or OTC).
The market for corporate bonds in Vietnam is still underdeveloped due to:

1. Credibility: Investors appear skeptical on corporate bonds as Vietnam does not have reputable credit rating agents. This is allegedly the main reason only well-known, reputable, high profile state-owned enterprises issue corporate bonds.
2. Liquidity: Because of the small market size, investors are concerned about the liquidity of corporate bonds although government bonds issuance have been increased.
3. Varieties of bonds: As numbers of bond issuers are limited, investors do not have a wide selection for corporate bonds.
4. Corporate awareness: Not all corporate financial officers in Vietnam are familiar with the actual costs and benefits of issuing bonds. Most corporations prefer to issue shares (far higher than par) over corporate bonds, where they must honor periodical coupon and principal payment commitments.

Although VNBF provides daily fixing of bond rates on Bloomberg, these are reference rates only, not dealing rates. Almost all bond purchases are by institutions, particularly insurance companies. However, several investors have expressed an interest in corporate bond issues if they were to develop.

Payment system & technology

Payment system is functional, but technically not very developed, due to poor payment infrastructure and unavailability of products and services. Cash remains the main method of payment, especially among individuals, despite a drop in cash payment percentages from 20% in 2004 to 18% in 2006 (target is 15% by 2010 and 10% by 2020). Although the number of individual accounts jumped from six million to eight million 2007, account users are mainly high income earners in urban areas or in large companies.

At the moment, there are six systems of payment among banks in Vietnam: paper-based clearing (started in 1991), the card payment system (1993), SBV electronic transfer system (1998), electronic clearing (2002), banks' internal payment system (2002), and inter-bank electronic transfer (2002). The inter-bank electronic transfer system now performs 35-45,000 payments per days with VND 33 billion.

Despite significant growth during the last three years (as depicted in Table 9 below), the level of technology of Vietnamese financial institutions is still far behind neighboring countries like Thailand, Singapore, and Malaysia. The level of technology also varies significantly among banks, with most first-tier banks in the market and VCB having advanced core banking system technologies that support a full range of banking services (including internet banking, ATMs, phone banking etc.) as well as risk management. However, services offered, such as internet banking, are still limited to basic outstanding and transaction history inquiries. In contrast, the vast majority of second-tier and rural local commercial banks lack advanced technology. Many still operate on backward stand-alone and paper-based systems that are not collected online, which exposes them to serious operational and portfolio management risk and low efficiency levels. Overall, foreign bank branches have an absolute competitive advantage over local commercial banks. Foreign banks like Citibank, HSBC, Deutsch Bank, and ANZ, for example, provide full services internet banking.

Table 9	State of Technology of Vietnamese Banks	
Modern banking applications	2007	2006
Banks with Core Banking System	20	12
Online transactions/millions (day)	4.2 - 6.3	3-4.5
Banks equipped with ATM and POS	30	15
- Number of ATMs	4,500	3,820
- Number of POSs	22,959	21,875
Banks that issue payment cards	30	25
- Number of cards (million)	8	6
Banks with Internet Banking	17	17

By 2007, there were four card union banks that accept each other's cards: VCB, VNBC, Banknetvn and ANZ/Sacombank. Banknetvn and Smartlink having 70% total of ATM machines are now connected. The core banking payment system has been extended to approximately 20 banks.

Interbank / Money Market

There is no official, central bank driven interbank market. However, individual banks do cooperate and engage in lending with each other. Overnight interbank rates reached a peak of 43% in February 2008, due to the liquidity shortage. SBV has a project to facilitate the payment system from 2007 to 2010, which includes the completion and development of an Interbank payment system.

Deposit Insurance

Deposit insurance was instituted in Vietnam in the year 2000 with total capital of VND 10,000 billion (US$ 625million), covering deposits of VND 50 million (US$ 3,125) per individual per bank. The Vietnam deposit insurance has headquarters in Hanoi and six branches with a total of 600 staff. The Deposit Insurance of Vietnam (DIV) is vested with independent examination powers, but relies heavily on the SBV. Under the current regime, a bank must pay an annual premium of 0.15% on average on all VND balances, while foreign currencies are not covered. Extending coverage might provide a higher degree of depositor comfort and assist in deposit mobilization. The laws on deposit insurance are being drafted.

Accounting Standards

There have been a number of positive, albeit gradual developments in this area. As promulgated by the central bank, banks are gradually introducing international accounting standards (IAS).

Accounting standards are rudimentary and disclosure is poor, which is consistent with the integrity of the data disclosed. Although Vietnamese accounting standards have evolved from cash to an accrual basis and toward IFRS, they are not yet fully in line with international standards. VAS differs from IFRS in a number of important areas, such as on loan loss provisioning, accounting for investments activities, financial liabilities, derivatives and off balance sheet transactions. In addition, a VAS standard set of financial statements for banks lacks a clearly defined set of rules and guidance on areas to be presented or disclosed, resulting in an absence of information on some banking activities, especially new banking transactions.

One positive development has been SBV's introduction of the requirement that banks record their NPLs which is closed to IAS as in Article 7 of Decision 493/2005/QĐ-NHNN dated 22 April 2005. As part of the reform process of the financial sector, it is planned to gradually introduce a requirement of IFRS reporting, especially for those standards that currently do not exist under VAS, such as IFRS-based loan loss reserve requirements. The reform process will help strengthen the transparency of the Vietnamese banking system and establish the conditions necessary for regional and international integration.

Audit & Legal

Auditing is mandatory for all commercial banks operating in Vietnam. Most Tier 1 JSBs, state-owned, and foreign banks are audited by international auditing firms. There are a number of good quality domestic accounting firms that provide audits in both VAS and IFRS. Not all banks publish audited reports, or at least not in a timely fashion. If/when published, only a fraction of the audited report is shown and financial statements, auditor's notes, management opinion, etc. are often missing in the statements of smaller JSBs.

Credit Information & Rating

The Credit Information Center, a public credit registry under the supervision of the State Bank of Vietnam, is the only central credit information resource in Vietnam to date. From 2004, CIC began providing access and standard products and services to other parties in the economic sector for a fee. With the rapid growth in all economy sectors, demand for consumer consumption has expanded rapidly. This has consequently created an urgent need for consumer credit information from all lenders.

CIC does not have the capacity or knowledge to respond to the needs of the retail sector.To complement the work of CIC and promote a stronger and more efficient credit reporting and information infrastructure in Vietnam, the emergence of credit bureaus is required. Legal reform is currently underway to promote and facilitate the establishment of private credit bureaus in order to respond to the needs from lending sectors.

The information collected and shared by the credit bureaus should be both positive (credit card limit, date of loan granted, number of payments made, loan data, etc.) and negative (non-payment of loans, legal proceeding and foreclosures, etc.). Credit bureaus should share the information collected with a broad range of users for a fee. Private credit reporting is a crucial instrument in the economy and provides a service to potential borrowers who can build their credit history with a good payment record that can serve as intangible collateral for future borrowings. This is important in Vietnam where the majority of enterprises are household businesses, small merchants and traders, or farms that normally face difficulty with satisfying collateral terms.

PCB company was established at the end of 2007 by a consortium of 11 commercial banks to operate the first private credit bureau (once the legal framework is in place in late 2008). By using the most up-to-date credit bureau system from an international software vendor, PCB's goal is to get all major credit lenders in both banking and non banking sectors to participate as data providers for both consumers and SME's credit information, including utility and telecommunications companies.

The Credit Ratings Vietnamnet Centre, Vietnam's first-ever credit rating agency, was set up by the VASC software and media company early June 2005. The centre aims to provide investors interested in Vietnamese firms a better foundation for making investment decisions. However, concerns have been raised about the efficiency of the newly-established Vietnam credit rating center as regards a lack of government ministry and agency transparency.

World' vest Base Inc. in Hanoi received the license from Vietnam Government to act as credit rating agency in Vietnam on May 15, 2007. Private owned and totally independent, the agency is building the financial database of about 16,000 private companies in 61 cities & provinces of Vietnam with the purpose of acting as a bridge to promote Vietnam companies to join the global capital market and enhance financial transparency in Vietnam. Fitch monitors Vietnam out of Singapore, but concentrates its rating on the top ten financial institutions.

Development Bank

The newly-founded state-owned Vietnam Development Bank, which was converted to a regulated institution out of the Development Assistance Fund (DAF), is to act for development. The VDB has three main tasks: (i) mobilizing and receiving funds to finance state development; (ii) implementing development investment policy; (iii) managing ODA on-lending funds. The VDB is governed by the Law on Domestic Investment Encouragement; it is not under any banking laws. It reports to MOF but is under the responsibility of the Prime Minister, who approves and amends its charter, issues policies, and provides operational guidance.

Industry Associations

Vietnam features an association of bankers (VNBA), founded in 1994, that has grown into a voluntary membership organization of 49 financial institutions, including five SOCBs, 35 JSBs, one JVB, and eight other non-bank financial institutions. It has expanded its activities into information sharing, training, legal advice, match-making and representation/cooperation with international forums. In comparison with other industry associations, VNBA is considered to be active and well-sustained due to a strong and growing banking sector.

The Vietnam Association of Financial Investors (VAFI) was established in 2004. VAFI has admitted nearly 200 members, of which 63 are organizations. The association is a bridge between investors, stock companies, and funds management agencies. The Association is tasked with improving the investment environment, protecting the rights of investors, promoting the financial investment domestically and overseas, and consulting state management agencies on financial policies and regulation.

The Vietnam Insurance Association (AVI), established in 1999, has 29 official members who are insurance firms, and 25 associated members who are brokers, loss adjustors, etc. Its main activities include providing inputs to insurance-related legal documents and products, promoting insurance businesses, and training.

Training, Education

The banking sector relies heavily on the local banking university and in-house training units to meet staff training needs. The Bank Training Center (BTC) can provide modern, high quality training products, but it is far from the largest supplier. The BTC has recently expanded its services to include consulting services and surveys of the Vietnamese financial market. There are a number of domestic and international consulting and training companies operating in Vietnam; none, however, with an exclusive focus on the financial community.

The development of the capital market and the entrance of a number of foreign financial institutions onto the market have absorbed the pool of qualified and experience labor. This leads to greater operational risk throughout the industry.

Consumer Education

Consumer financial education is still limited, especially in rural areas. While there is an acceptable level of understanding of basic financial products/services (remittances, deposits), there is very limited understanding of the more sophisticated products, including receivable financing, leasing, mortgage, insurance, etc.
Although much of the capital market is driven by foreign investment, a large amount of investment is from local retail speculators who do not understand basic business and financial fundamentals.

Legal, Regulatory, and Policy Framework

The domestic banking sector is still protected, a characteristic held over from the mono-bank system. The government relies on the SOCBs for policy lending and all levels of the administration interfere with credit decisions of these banks. Protection has led to an uneven playing field for state-owned and privately-owned financial institutions.

Foreign private institutions are still limited in regard to business activities, market entry, expansion, ownership and investments in local financial institutions.

In line with WTO commitments, however, Vietnam's banking sector is gradually opening up to foreign banks. As of 1 April 2007, foreign-owned banks operating in Vietnam are eligible to provide the full range of services as local banks, including mobilizing funds in local currencies.

In 2012, foreign banks with minimum assets of US$ 20 billion (currently US$10 million) will be able to set up and operate in Vietnam under the same regulatory requirements as domestically owned banks.

Reform Process

The government has embarked on a financial sector reform program, as part of a World Bank Poverty Reduction Support Credit (WB-PRSC) loan. This loan supports the initiation of fundamental changes in the financial sector, and is designed to transform the SBV into a modern central bank, strengthen the commercial orientation of SOCBs, and develop capital markets. Towards this end, a banking reform road map was signed by the Prime Minister in May 2006. The road map focuses on restructuring the SOCBs as well as the SBV, separating the supervisory from the ownership function, strengthening banking supervision, and aligning regulatory standards with the Basel Core principles. In 2007 and early 2008, the equitization plans allowing strategic investors for two SOCBs were approved. Also, SBV issued a road map to enhance bank supervision and the role of bank boards of directors.

The equitization process of SOCBs is slower. Only VCB completed equitization in 2007, MHB is scheduled in 2008 while BIDV and Vietinbank may be in 2009.

As a requirement of its WTO accession, Vietnam allows foreign banks to apply for full bank licenses in 2007. This increases competition among foreign and joint-stock banks for the "top-tier" clients.

Corporate Governance

Potential conflicts of interest and inadequate decision-making structures may seriously impede development. Further improvements are urgently needed to facilitate both the entrance of foreign banks and the rationalization of existing processes (e.g., equitization). The most important of these are: (a) leveling the playing field by applying a similar governance structure to SOCBs and JSBs (b) resolving the conflicts of interest posed by the different roles of SBV and the SOCBs, (c) clarifying the respective competences of directors and executive managers, (d) delineating ownership representation at the Supervisory Board of SOCBs and clarifying its functions, (e) separating the audit and risk control functions from management, and (f) acknowledging and strengthening the rights of minority shareholders, particularly those in equitized enterprises and JSBs.

Regulation & Supervision

The State Bank of Vietnam (SBV) is responsible for regulating and supervising the banking system. The SBV has a regional structure with over 60 branches, controlled by the local government. This high level of fragmentation limits its efficiency. Also, the central bank's co-ownership of the SOCBs creates a conflict of interest which may diminish the independence of its supervisory oversight.

The Law on State Banks of Vietnam (LSBV) and the Law on Credit Institutions (LCI) provide a robust framework for the regulation and prudential supervision of the Vietnamese banking sector. Together they cover the activities of the central bank and all commercial credit institutions operating in Vietnam, and address issues such as fair competition, business autonomy, and prudential regulations. In addition, a large number of decrees and regulations exist to further detail procedures. A decree on the formalization of semi-formal microfinance organizations has recently been passed, which is unfortunately flawed in many respects (i.e. coverage); therefore, it remains to be seen if it will have a positive effect on the industry.

In June 2007, The SBV issued decision No. 24/2007/QD-NHNN to increase minimum capital requirements for establishing banks to US$ 63 million (VND 1 trillion), and to US$ 190 million (VND 3 trillion) after 31 December 2008. In addition, the requirement of 100 shareholders will likely hinder entrance to the sector.

The regulatory framework only supervises a particular type of financial institution instead of a business function. The supervisory regime itself is heavily rules-based, with an emphasis on financial institutions complying with laws and regulations.

Although the SBV has introduced some requirements on capital, collateralization, asset quality, and provisioning by type of financial institution, banks are not required to publish details of their performance against these standards, so transparency is an issue. Similarly, the SBV is reluctant to publish sector data.

Poor coordination between different state management agencies is a significant problem. This has prohibited a comprehensive financial sector master plan linking the banking sector with the capital market and other sectors.

Supervision at SBV and State Security Committee (SSC) is hampered by an absence of an effective reporting, monitoring and a statistic database system.

Legal Environment

The legal infrastructure is weak in comparison to global standards. The difficulties of enforcing security and foreclosing on loans are a major impediment to the development of the residential mortgage market. Foreign banks have only recently been allowed to accept land-use-rights as collateral for loans, though the enforcement of this security has not been tested. Seeking recourse via the court system is time consuming and costly.

Bankruptcy law only exists on paper, as no bankruptcy has ever occurred. Foreclosure is lengthy and costly, making it almost impossible. Tax laws are adequate but considered too complicated with tax incentives not well structured, nor performance based.

The current legislation leaves the banks with the discretion as to whom confidential banking information is released. Thus, many smaller private customers are unwilling to provide detailed financial information to financial institutions. This in turn leads to a lack of reliable financial information for credit decisions on the banks’ side.

Gap Analysis

Summary of Gaps

Banking Environment

1. Macro economic conditions worsen (inflation, devaluation in VND)
2. Limit on loan growth of 30% for 2008.
3. Higher reserve requirement by SBV
4. Lack of market information
5. Unwillingness to disclose personal financials is an indication of weak banking secrecy laws as clients fear that financials are reported to tax authorities. Therefore, lack of reliable information for credit decisions.
6. A weak legal system makes legal recourse lengthy and costly
7. Differential treatment of SOCB and private FIs.
8. Corporate governance issues resulting out of SBVs dual role as owner of the SOCBs and its supervisory function.
9. Differences between VAS and IFRS, especially with regard to loan loss provisions and NPL reporting, create overvaluation of assets. Lack of transparency.
10. Poor coordination among regulators in the financial sector, lack of comprehensive integrated master plan for financial sector.

General Banking

1. All financial intermediaries have very similar business strategies
2. Products available in the market (credit, deposits, and services) are limited to basic loans, deposits, and payment products.
3. Inadequate MIS and technological capacities.
4. Organizational structure and network and distribution channels of banks are neither suited for the expansion of product range, nor the increase in outreach.
5. Inadequate term structures result in maturity mismatches incurred by all banks, as short-term deposits are utilized for medium-term lending.
6. Prices are highly distorted as there is no risk-based pricing and high borrowing rate, especially from market makers (SOCBs).
7. Limited exit options (capital markets are underdeveloped) and no secondary credit market.
8. Weak risk management, and overall limited experience/knowledge of staff
9. Overall undercapitalization with minimum capital requirements increasing.
10. Overexposure of SOCBs to loans to SOEs

Microfinance

1. Highly distorted market
2. Semi-formal MFIs are small with limited outreach.

Capital Markets

1. Liquidity concerns and a decrease in demand of foreign buyers.
2. Consecutive downgrades since beginning of 2008 (from almost 1200 points in March 2007 to 400 points in June 2008)
3. Insufficient qualification of key participants (brokers, investment houses, dealers, and regulators), Supervision and enforcement capabilities of SSC limited.

11. Insufficient SCIC capacity to evaluate SOEs prior to privatization.
12. Lack of a credit rating agency to provide information on borrowers.
13. Lack of consistent legal framework for securitization, pension funds, minorities' shareholders' right protection, bond issue practices.
14. Large, unregulated OTC market with unregistered securities traders and investors with little knowledge and experience competing with legal markets.
15. Poor public awareness on corporate bonds as an alternative source of financing.
16. Inactive secondary market for bonds trading
17. SMEs left out of formal securities market
18. Poor disclosure practices for IPOs and bonds issuance

19. Poor intermediation, insufficient capacity of securities firms in compliance, risk management, internal controls, operations and poor monitoring and supervision.
4. Absence of a centralized registry system for securities and an integrated securities depository system.
5. Absence of trust or agency law.
6. Availability of very basic products only.

Leasing

1. Absence of Trust Law.
2. Flawed leasing legislation
3. Lack of regulation on the repossession process and sales of leased assets
4. Limited understanding of leasing by clients and by leasing companies
5. Constraints in accessing medium and long-term funds
6. Cost of funds and pricing issues
7. Conflicting legislation on ability to sell rights and obligations under leasing contracts

Insurance

1. Lack of good quality, high-yield long-term investments in local currency. Problems include unstable capital markets, volatility and lack of depth in bond markets, and unstable real estate market.
2. Limited availability of products, as outreach is limited to urban areas.
3. Limited understanding/knowledge of products (especially non-life) by consumers.

Housing

1. Lack of transparency, hard to buy directly from housing companies.
2. Real estate bubble in 2007.
3. Unclear legal situation pertaining to property and/or land use rights hampers foreclosure on land and buildings.
4. Weak repossession enforcement system.
5. No registry for either land or property titles or land use rights.
6. Banks lack long-term funding sources required for mortgage lending development.
7. Legal system is not sufficient for introduction of mortgage-related products.
8. Limited product development at bank level.

IFC / MPDF Activities

IFC, in cooperation with the SBV, currently supports the development of a private credit bureau to decrease information asymmetries in the market through the development of a strategic framework and partnership building.

IFC is also supporting the Ministry of Justice in developing the legal framework for a movable asset registry – The National Registration Authority on Secured Transactions, or NRAST. It also is increasing public awareness and knowledge dissemination for end users of the system

Sector-wide capacity building is provided through the Bank Training Center, which has been developed by IFC and recently posted a profit in addition to significantly expanding its services.

Recently, IFC has launched an SME lending program where it helps individual banks to increase product service and distribution channel development in order to expand access to finance for SMEs.

The other projects will be launched are housing finance and capital market enhancement.

Other Donor Activities

General Banking and Bank Restructuring

Donor efforts are spread across a number of different financial and banking systems areas. Organizations such as ADB, CIDA, GTZ, USAID, the IMF, JICA, and EU are providing loans and assistance for improving the supervisory, regulatory, and legal frameworks of the financial sector, as well as providing specific support to the SBV as it moves towards becoming a modern central bank. Other areas targeted by donors include technical assistance to reform and equitize SOCBs (ADB), to modernize the payment system (AFD, JICA/BOJ, IMF, JICA, and to provide trainings to build bank capacities (GTZ, CIDA, EU, IMF)

Capital Markets

The Government of Luxembourg supports the SSC to develop the legal framework for securities market development, build capacity for SSC and other securities intermediaries, and provide public and investor education and training. Seco provides support to SSC through training institute trainers. GTZ is providing ongoing support for the development of the bond market, Vietnam Securities Depository, and money settlement for securities trading. USAID is also providing assistance for the development of the securities market, specifically targeting the SSC. Areas of assistance include development of a legal framework, building capacity of the SSC & other securities intermediaries, and providing public and investor education and training.

Insurance

The ADB & AfD are providing ongoing support for the development of the insurance industry as a channel for improving capital markets (increasing institutional demand).

Leasing

The ADB, AfD, and KfW support the development of leasing companies as a channel for improvement of capital markets and provide ordinary capital resources leasing investment loans to subsidize leasing companies which are listed in the 2007-2010 Country Strategy Program.

Housing

The ADB continues to provide assistance to the Housing Finance Facility. AfD provides assistance to the Mekong Housing Bank for IT and MIS improvement, human resource development, and internal auditing training, as well as a Housing Credit Line through MHB.

SME / Microfinance

ADB is supporting the implementation of the regulatory and supervisory framework for microfinance. USAID provides IT, capacity building, and organizational development technical assistance to the Bank for Social Policy

The ADB and KFW supply TA and loans to VBARD and People’s Credit Funds for microfinance. Other organizations provide credit lines, loan guarantees, and TA to banks (ADB, JICA, EU, and USAID) in order to promote credit extensions to SMEs. Programs that support the National Registration Agency of Secured Transactions and a credit-rating bureau also support the extension of credit to SMEs.

ABBREVIATIONS

ADB	:	Asian Development Bank
AfD	:	French Development Agency
AVI	:	Vietnam Insurance Association
BTC	:	Bank Training Center
CAR	:	Capital Adequacy Ratios
CIDA	:	Canadian International Development Agency
DAF	:	Development Assistance Fund
EIU	:	Economist Intelligence Unit
EU	:	European Union
FSPL	:	Financial Sector Program Loan
GAAP	:	General Accepted Accounting Principles
GDP	:	Gross Domestic Products
HASTC	:	Hanoi Stock Exchange
HOSTC	:	Ho Chi Minh City Stock Exchange
IFC	:	International Finance Corporation
IFRS	:	International Reporting Standards
IMF	:	International Monetary Fund
IPO	:	Initial Public Offering
JSB	:	Joint Stock Bank
KfW	:	German Development Bank
LCI	:	Law on Credit Institutions
LSBV	:	Law on State Banks of Vietnam
MIS	:	Management Information System
MOF	:	Ministry of Finance
MPDF	:	Mekong Private Sector Development Facility
NPL	:	Non Performing Loan
ODA	:	Official Development Assistance
PCF	:	People's Credit Fund
PVI	:	Petrol Vietnam Insurance
ROAA	:	Sector Average Return on Assests
ROAE	:	Return on Equity
SBV	:	State Bank of Vietnam
SCIC	:	State Capital Investment Corporation
SDPL	:	SME Sector Development Program Loan
SME	:	Small and Medium Sized Enterprises
SOCB	:	State Owned Commercial Bank
SOE	:	State Owned Enterprise
SSC	:	State Security Commission
VAFI	:	Vietnam Association of Financial Investors
VAS	:	Vietnamese Accounting Standard
VBSP	:	Vietnam Bank for Social Policies
VNBA	:	Vietnam Association of Bankers
VND	:	Vietnamese Dong
WB	:	World Bank
WB-PRSC	:	World Bank Poverty Reduction Support Credit

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