CAU Asia Focus

COUNTRY ANALYSIS UNIT | FEDERAL RESERVE BANK OF SAN FRANCISCO | JUNE 2011

Banking Reform in Vietnam

Vietnam's banking sector is expected to have one of the highest growth rates in Asia during the next few years due to the country's continued economic expansion, rising household incomes, and relatively low penetration of existing banking services. Over the past two decades, the Vietnamese government has undertaken a series of reforms to strengthen and modernize the sector as part of the country's move towards a more open and market-oriented economy. Many of these reforms have also been motivated by Vietnam's growing participation in international agreements and ongoing efforts to adopt international standards such as the Basel capital framework. Key reforms include a restructuring of the banking system, a gradual opening to foreign investment, the partial privatization of state-owned banking institutions, and measures to strengthen the capitalization of Vietnamese banks. This *Asia Focus* report provides an overview of Vietnam's banking sector, reviews significant developments since the mid 1980s, and highlights key challenges to reform implementation.

Profile of the Banking Sector

Rapid Growth

Vietnam's banking sector has expanded substantially in recent years. Total domestic assets in the system more than doubled between 2007 and 2010, growing from VND 1,097 trillion (USD 52.4 billion) to VND 2,690 trillion (USD 128.7 billion).[2] This figure is expected to grow to VND 3,667 (USD 175.4 billion) by the end of 2012.[3]

Rapid economic growth has contributed to rising household incomes and an increasing demand for retail banking services. Credit and debit card use has become more common, with the number of cards issued doubling between 2008 and 2010 to 28.5 million. The number of automated teller ma-

Figure 1: Vietnamese Banking Sector

State-Owned Commercial Banks (SOCB)	
Bank for Agriculture and Rural Development (Agribank) Mekong Housing Bank (MHB) Vietnam Bank for Social Policies [1] Bank for Investment and Development (BIDV)	100% Government Owned
Bank for Foreign Trade (Vietcombank) Industrial and Commercial Bank (Vietinbank)	Partially Equitized
Joint Stock Commercial Banks (JSCB)	
37 banks, including: Asia Commercial Bank (ACB) Techcombank Sacombank	
Wholly Foreign-Owned Banks	
HSBC Standard Chartered Bank ANZ Bank Shinhan Bank Hong Leong Bank	
Joint Venture Banks	
(JV Bank Name)	(Vietnamese and Foreign JV Bank Partners)
Indovina Bank	Vietinbank & Cathay United Bank (Taiwan)
VinaSiam Bank	Agribank & Siam Commercial Bank (Thailand)
Shinhanvina Bank	Vietcombank & First Bank Korea (Korea)
VID Public Bank	BIDV & Public Bank (Hong Kong)
Vietnam-Russia JV	BIDV & VTB Bank (Russia)

chines (ATMs) has also climbed dramatically, rising from 1,800 in 2005 to 11,000 as of December 2010.[4] Yet despite this growth, banking penetration rates remain relatively low. As of December 2009, an estimated 20% of Vietnam's population had bank accounts and around half of those with accounts actively used consumer banking services.[5] Although these figures have likely risen somewhat during 2010 given the rising trend in credit cards and ATMs, the Vietnamese market continues to present growth opportunities for banking service providers.

Types of Institutions

The banking sector in Vietnam is divided into four primary types of institutions (*Figure 1 on previous page*). These include six state-owned commercial banks (SOCBs), 37 joint stock commercial banks (JSCBs), five joint venture banks, and five wholly foreign-owned banks.[6]

SOCBs are majority government-owned institutions that the government initially established to fulfill a specialized policy lending function. SOCBs' traditional customer base has been state-owned enterprises (SOEs), although they are increasingly expanding into more traditional commercial banking activities and are no longer considered formal policy institutions.[7] Nevertheless, heavy lending to SOEs by SOCBs—notably prior to the 1997-98 Asian Financial Crisis—has led to relatively higher levels of non-performing loans (NPLs) than at other financial institutions.[8] SOCBs accounted for the largest share of lending, with 49.3% of total loans as of year-end 2010, down from 58.4% in 2007 (*Figure 2*).

JSCBs have more diversified shareholding structures than SOCBs, with both public and private shareholders. They specialize in lending to small- and medium-sized enterprise clients and in retail finance. JSCBs' market share has grown in recent years, due mainly to market share captured from the SOCBs.[9] Together with joint venture and wholly foreign-owned banks, they account for slightly more than half of total domestic lending as of end-2010 (*Figure 2*).

Joint venture banks are established with capital contributed by a Vietnamese bank and one or more foreign banks under a joint venture contract. The share of foreign investment in the joint venture is limited to 49%. Joint venture banks' activities are not restricted and are similar in nature to those of JSCBs.

Since 2006, the State Bank of Vietnam (SBV) has granted licenses to five foreign banks to operate as wholly foreign-owned banks. In their limited years of operation, the wholly foreign-owned banks have reported profits, in part due to high demand by foreign investors in Vietnam to open accounts with foreign banks and to use their trade finance and foreign exchange services. These banks have also looked to the growing Vietnamese middle class as potential customers for services in which foreign banks are perceived as having a competitive advantage over domestic banks, such as retail banking and wealth management services.

Profile of the Banking Sector

Early reforms to Vietnam's banking sector were part of the broader set of market-oriented reforms that the government began implementing in the mid-1980s. A number of these reforms focused on decentralizing and privatizing financial activities. Prior to 1990, the SBV functioned as both a central bank and a commercial bank. The 1990 Ordinance on the State Bank of Vietnam separated the central bank's functions and delegated its banking activities to four newly created SOCBs, each targeting a different sector of the economy.[10] The central bank's

Figure 2: Vietnam Banking Sector Loans by Institution Type (VND, trillions)

	2007	2008	2009	2010
SOCB Lending	623	763	982	1221
(SOCB % of total)	*58.4%*	*57.0%*	*52.5%*	*49.3%*
Joint Stock and Other Bank Lending	444	576	887	1254
(Joint Stock and Other as % of total)	*41.6%*	*43.0%*	*47.5%*	*50.7%*
Total	**1,067**	**1,339**	**1,869**	**2,475**

Source: International Monetary Fund and ASEAN Economic Bulletin industrial and commercial lending department was converted to the Vietnam Industrial and Commercial Bank (formerly Incombank, now Vietinbank), its agricultural department to the Viet Nam Bank for Agriculture and Rural Development (Agribank), its international trade department to the Bank for Foreign Trade of Vietnam (Vietcombank), and its infrastructure department to the Bank for Investment and Development of Viet Nam (BIDV). The SBV's role was narrowed to that of a central bank, including the formulation of monetary policy, management of foreign exchange reserves, and licensing and supervision of "credit institutions," a term that encompasses commercial banks.[11] The government also permitted the establishment of JSCBs and a limited foreign bank presence through joint-venture banks and foreign bank branches, which were restricted to engaging in certain types of activities.[12]

Many of Vietnam's more recent banking sector reforms have been motivated in part by the country's entry into international trade and investment agreements, such as the U.S.-Vietnam Bilateral Trade Agreement (BTA) in 2001, and its accession to the WTO in 2007. The resulting increased presence of foreign banks has prompted additional reforms to enhance the competitiveness and strength of domestic banks, including the SOCBs. These reforms include partially privatizing the SOCBs and strengthening bank capitalization. Efforts to bolster banks' capital bases are also aimed at achieving compliance with the international capital standards under the Basel capital accords.

Increased Presence of Foreign Banks

Vietnam started gradually opening its banking sector to foreign investment in the early 1990s, as discussed above. A foreign bank's access was initially limited to taking a minority share in joint venture banks and establishing branches and representative offices until 2004, when the government amended the 1998 Law on Credit Institutions to comply with the terms of the U.S.-Vietnam BTA. This amendment required Vietnam to allow 100% U.S.-owned subsidiary banks by 2010.[13] The amendments to the law set the stage for the establishment of wholly foreign-owned banks by investors from any country, which would eventually be required under Vietnam's WTO accession in 2007.[14]

In 2006, the government issued a decree specifying the requirements for establishing wholly foreign-owned banks and regulating the general operation of foreign bank branches and joint venture banks. The decree required foreign banks applying for a wholly foreign-owned banking license to have at least USD 20 billion in assets in the year prior to application and required a single parent bank to own at least 50% of the new bank's capital.[15] The decree also relaxed restrictions on foreign investment via foreign bank branches and joint venture banks by extending their license periods and by expanding foreign branch service transaction points to include ATMs, also required under the BTA.[16] Vietnam further leveled the playing field for foreign banks on January 1, 2011, by granting foreign branches equal treatment as domestic banks, complying with its WTO commitments. Foreign branches and domestic banks are now subject to the same deposit and lending rules and are permitted to provide the same banking services.

Partially Privatizing State-Owned Commercial Banks

To complement opening local banking markets to foreign players, the government recognized the need to strengthen the competitiveness of domestic banks. The government's plans include the May 2006 announcement to "equitize," or partially privatize, the SOCBs and reduce government ownership to 51% by 2010.[17] To help facilitate this process, in 2007 the government raised the maximum stake a single strategic foreign investor could hold in a domestic commercial bank, including SOCBs, from 10% to 15% of the bank's chartered capital.[18] The SBV may "in special cases" grant an exception to individual strategic foreign investors, allowing investment of up to 20% of chartered capital in an SOCB.[19] Whatever the level of investment, strategic foreign investors must commit in writing to assisting the domestic bank in developing products and services and in improving managerial and technological capacity.[20] The government capped non-strategic foreign financial institutions' ownership of a domestic commercial bank at 10% and all other foreign investors' ownership at 5%. Total foreign ownership of a domestic commercial bank was capped at 30%, and the government required investors to hold shares for at least five years to curb share speculation and ensure the investors' commitment to Vietnam.

Despite the government's goal of equitizing all SOCBs by 2010, as of April 2011 only two—Vietcombank and Vietinbank—had successfully sold shares to private investors. Vietcombank became the first SOCB to hold an IPO, selling a 6.5% stake for VND 10.5 trillion (USD 652 million) in December 2007.[21] However, it was unable to attract a single strategic foreign investor willing to take a 20% stake, a requirement of the bank's equitization plan. Because the bank was not in compliance with the equitization plan, in December 2009 the government halted Vietcombank's plans to raise an additional VND 1 trillion (USD 48 million) through the sale of shares to existing shareholders.[22] To comply with its equitization plan, Vietcombank will reportedly seek strategic investors in 2011.[23] Vietinbank successfully sold a 4% stake to private investors in its December 2008 IPO, raising VND 1.1 trillion (USD 64 million).[24] In January 2011, it sold an additional 10% of its shares to the International Finance Corporation, which became its sole strategic foreign investor, for USD 182 million.[25]

The equitization status of the remaining SOCBs remains somewhat uncertain. In April 2010, the government approved an equitization plan for Mekong Housing Bank (MHB), through which the bank would sell a 15% stake to strategic investors and an additional 14.34% stake to the public. However, the government has not yet announced a date for the planned IPO, nor has it identified potential strategic investors.[26] BIDV initially planned to conduct an IPO in 2008 but twice postponed the sale of shares due to the poor performance of the domestic stock market. The bank reportedly plans to conduct its IPO in the second half of 2011 and sell up to a 20% stake, 10% of which might go to a strategic investor.[27] In February 2009, the SBV approved a plan for Agribank to become a single-member limited liability company entirely under government ownership.[28] The government has not announced a date for the plan's enactment, nor has it indicated whether the government-held shares will eventually be sold to private investors. It also remains unclear whether the government will equitize the Vietnam Bank for Social Policies.

Strengthening Bank Capitalization

Stronger capital is a key component of reform efforts to improve the competitiveness of Vietnam's domestic banks as foreign presence increases. The SBV employs two tools for measuring banks' capital adequacy. The first is a minimum nominal amount of capital that banks must hold. This amount varies depending on the type of bank, but it does not automatically adjust upward as banks grow their assets and assume more risk.[29] The SBV also requires banks to meet a minimum capital adequacy ratio, which measures total capital as a percentage of risk weighted assets.

The government's November 2006 Decree 141 increased the minimum notional capital levels required of all credit institutions.[30] Specifically, the decree required all commercial banks to hold at least VND 3 trillion (USD 143 million) in capital, up from the prior minimum of VND 70 billion (USD 3.3 million). (The minimum capital requirement for foreign bank branches was left unchanged at USD 15 million.) To monitor compliance with the decree, the SBV required all banks to submit recapitalization plans for approval. Banks that did not yet meet the requirements were required to submit monthly progress reports. The decree stated that any commercial bank that could not meet the requirement by December 31, 2010, would be forced to merge, have its scope of operations reduced, or have its banking license revoked. Twenty commercial banks, including the major banks, were able to meet the new requirement by the deadline (*Figure 3 on next page*); however, 29 other commercial banks were unable to do so due in part to the poor performance of the stock market and the increase in bank share issuance as many institutions sought to raise capital simultaneously. As a result, in January 2011, the government extended the deadline through December 31, 2011.[31] Even with an additional twelve months to meet the capital requirement, it will be challenging for many smaller commercial banks to attract significant investment.

Effective October 2010, the SBV raised the minimum capital adequacy ratio to 9% from the 8% previously required.[32] Notably, this ratio is one percentage point higher than the minimum required under the Basel capital framework. The SBV also increased the risk weightings for certain assets, including loans for the

Figure 3: 2010 Capitalization of Selected Major Banks		
Bank	**Chartered Capital in Trillions of VND (USD, millions)**	**Capital Adequacy Ratio**
Agribank	20.1 (961.4)	9%
Asia Commercial Bank (ACB)	9.3 (444.8)	9%
Sacombank	9.2 (440.1)	10-11%
Techcombank	7.0 (334.8)	10%
Vietcombank	17.6 (841.8)	9-10%
Vietinbank	15.1 (722.3)	9%
Source: Various bank and news reports through February 2011		

purpose of securities investing and real estate business purposes.[33] These measures appear aimed at bringing the banking sector closer to compliance with the recently proposed capital requirements under the Basel III capital framework.

Looking Ahead

Within a relatively short period of time, Vietnam's banking sector has transitioned from one dominated by state-owned commercial banks and no foreign participation to one with a more diversified set of market participants, including state-owned banks, partially privatized banks, joint ventures and foreign institutions. The growing presence of foreign banks—through investments in Vietnamese banks and the establishment of wholly foreign-owned banks—is likely to motivate domestic institutions to improve their competitiveness and risk management capabilities going forward. Additionally, the government has implemented measures to strengthen the capitalization of banks, improving the ability of local banks to weather future economic and financial downturns. These measures also move Vietnam closer towards compliance with the international capital standards under the Basel framework.

The government faces a number of challenges as it moves forward with further reform and development of the banking sector. As the December 2011 deadline for the new minimum capitalization requirement approaches, competition for capital among banks will increase. This could lead to the merger or closure of smaller banks that are unable to meet the new requirements. Capital raising efforts are also likely to be made more difficult by recent declines in equity values. Lower equity prices may also create difficulties for the government as it continues to search for strategic shareholders to provide investment and expertise to newly equitized SOCBs. Further, the SBV recently announced new limitations on foreign investment in SOCBs, requiring at least USD 20 billion in assets for investors wishing to invest in more than 15%. These restrictions could limit the number of potential investors and delay the equitization process.[34]

Despite these challenges and obstacles, it is encouraging to see the progress the authorities in Vietnam have made to diversify the market participants in the banking industry, strengthen the resiliency of the banking sector, and follow internationally accepted banking standards. The success of further reform and development programs will likely depend on how well authorities can address remaining challenges.

<u>*Endnotes*</u>

1. The Vietnam Bank for Social Policies is sometimes classified as a state-owned social policy bank.
2. Unless otherwise noted, all exchange rates used throughout reflect the interbank mid-point rate as of March 31, 2011 (VND 20,906.70 = USD 1.00). (*Source*: Oanda.com.)
3. International Monetary Fund. "Staff Report for the 2011 Article IV Consultation for Vietnam." April 12, 2011.
4. Vietnam Banking Finance News. "Vietnam central bank proposes tasks for banking sector in 2011." December 29, 2010.
5. Vietnam Financial Review. "Vietnam's Retail Banking Report." January 12, 2011.
6. Number of banks are from the State Bank of Vietnam.
7. World Bank. *Banking Sector Review: Vietnam.* June 2001; and ASEAN Economic Bulletin, Vol. 26 Number 1. "Banking and Financial Sector Reforms in Vietnam." April 2009.
8. The official Vietnamese government figure estimates that about 2.5% of total outstanding loans were non-performing as of year-end 2010. SOCBs reportedly held around 60% of total NPLs. (*Source*: Vietnam Banking Finance News. "Adding

Vinashin's debt, banks non-performing loans rise by 0.7 pct." December 27, 2010.)
9. ASEAN Economic Bulletin, Vol. 26, No. 1, April 2009.
10. World Bank. "Viet Nam Financial Sector Review: An Agenda for Financial Sector Development." March 1, 1995.
11. Article 3, Ordinance on the State Bank of Vietnam. May 23, 1990. (*Note*: "Credit institutions," as defined by the Law on Credit Institutions, are enterprises that conduct monetary business and provide banking services, including deposit taking, lending and payment services.)
12. Fitch Ratings. "Country Report: The Vietnam Banking System." July 10, 2002.
13. U.S.-Vietnam Trade Council.
14. These requirements were specified in Decree 22-2006-ND-CP.
15. Article 7.6 and Article 8.2(b) of Decree 22-2006-ND-CP.
16. Article 11 and Article 32 of Decree 22-2006-ND-CP.
17. Federal Reserve Bank of San Francisco, Country Analysis Unit. "Vietnam's Banking Sector." February 2008.
18. Decree 69/2007/ND-CP on the Purchase by Foreign Investors of Shareholding in Vietnamese Commercial Banks.
19. Article 4.4 of Decree 69/2007/ND-CP on the Purchase by Foreign Investors of Shareholding in Vietnamese Commercial Banks. Notably, the government has granted exceptions to the 15% investment ceiling in three cases as of early 2011: HSBC's purchase of 20% of Techcombank, Maybank's purchase of 20% of ABBank, and Societe Generale's investment in SeaBank. (*Source*: Vietnam Investment Review. "Banks start to look offshore." May 25, 2011.)
20. Article 12.4 of Decree 69/2007/ND-CP on the Purchase by Foreign Investors of Shareholding in Vietnamese Commercial Banks.
21. Financial Times. "Vietcombank IPO sets tone for state issues." December 27, 2007. (*Note*: FX rate is from article.)
22. Saigon Money. "Vietcombank can't raise capital without foreign partner." January 3, 2010. (*Note*: FX rate is from article.)
23. Bloomberg. "Vietcombank to Select Partners This Year to Cut State Ownership." January 25, 2011.
24. Bloomberg. Vietinbank Raises $64 Million From Initial Share Sale." December 25, 2008. (*Note*: FX rate is from article.)
25. Saigon Times. "IFC busy into VietinBank." January 27, 2011.
26. Bloomberg. "Vietnam's Premier Approves Mekong Housing Bank Share Sale Plan." April 26, 2011.
27. Bloomberg. "Vietnam BIDV May Sell Shares in IPO in Second-Quarter, VIR Says." November 28, 2010.
28. VietFinanceNews.com. "Agribank to become limited company." February 9, 2011.
29. Fitch Ratings. "Country Report: The Vietnam Banking System." March 24, 2006.
30. Decree 141/2006/ND-CP.
31. Decree 10/2011/ND-CP.
32. Circular 13/TT-NHNN.
33. Vietnam News Agency. "Central bank redefines circular." September 28, 2010; and, State Bank of Vietnam. Circular No. 13/2010/TT-NHNN. Article 5.6.
34. Reuters. "Vietnam Limits Investment in State Banks." April 27, 2011.
35. International Monetary Fund. "Staff Report for the 2011 Article IV Consultation for Vietnam." April 12, 2011.

Contacts: Walter Yao (walter.yao@sf.frb.org) and Nkechi Carroll (nkechi.carroll@sf.frb.org)
Written by: Anne Ho and R. Ashle Baxter

SYMPOSIUM ON ASIAN BANKING AND FINANCE

FEDERAL RESERVE BANK OF SAN FRANCISCO

Asian Financial Institutions: Risk Management in a Global Environment

SEPTEMBER 8-9, 2011
San Francisco, CA

The Federal Reserve Bank of San Francisco is pleased to announce that **registration is open** for our symposium on Asian banking and finance, entitled ***Asian Financial Institutions: Risk Management in a Global Environment***, on September 8-9, 2011 in San Francisco. This year's symposium continues our tradition of examining emerging trends and issues that will impact banking and financial centers both in Asia and in the United States. Specifically, we will examine the complex issues that are part of managing risk in a global environment, and how financial institutions in Asia are balancing regulation, risk and innovation.
The symposium will commence with a keynote address from **Mohamed El-Erian**, Chief Executive Officer, PIMCO.

To see the **full agenda and register online**, please visit:
http://www.frbsf.org/banking/asiasource/events/2011/1109/agenda.html

Early Bird Registration Rate is $450.