Asia Focus

COUNTRY ANALYSIS UNIT FEDERAL RESERVE BANK OF SAN FRANCISCO FEBRUARY 2008

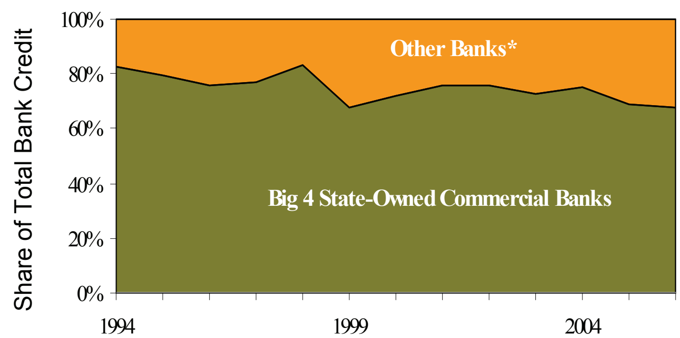
Vietnam's Banking Sector

Each year, the President of the Federal Reserve Bank of San Francisco (FRBSF) travels on a "fact-finding" trip to Asia. These trips advance two of the Bank's broad objectives: serving as a repository of expertise on economic, banking, and financial issues relating to the Pacific Rim and building ties with policymakers and economic officials there. The knowledge gained and the contacts developed during these trips provide valuable input to understanding trends affecting the Twelfth District, carrying out responsibilities in banking supervision, and conducting monetary policy and promoting the stability of financial markets. This ***Asia Focus*** *is based on President Janet Yellen's observations of developments in the Vietnamese banking sector made during her visit to the country in November 2007[1]. This trip represents the first time Federal Reserve officials have visited Vietnam since normalization of bilateral relations in 1995.*

Banking sector reforms lead the way

Similar to China, Vietnam has made bank reform a key element of its transition toward a more market based economy. Over the last 20 years, Vietnam has been executing a deliberate process of reform that has resulted in the dismantlement of its large monobank, the creation of four public sector banks, the establishment of joint-stock commercial banks (JCSBs), the opening of the banking sector to foreign participation, the development of an improved supervisory framework, and preparations to equitize and list shares in the state banks. Throughout this process, the government has attempted, with varied success, to weaken the linkages between state-owned enterprises (SOEs) and the state-owned banking system and to professionalize bank management.

Figure 1: Distribution of Credit in Vietnam



Source: IMF

*Other Banks include: JSCBs, foreign branches/subsidiaries, JV banks, and credit cooperatives.

Four state-owned commercial banks (SOCBs) dominate the domestic banking sector, accounting for over two-thirds of total banking system assets (see Figure 1). All four are owned by the State Bank of Vietnam (SBV), the country's central bank, which is heavily involved in their day-to-day management and controls the appointment of board members and senior management. SOCB provincial branches are reportedly prone to interference by local government and party leaders and operate outside the direct control of headquarters. Each SOCB originally specialized in a particular area of finance: Bank of Foreign Trade (Vietcombank) – to finance external trade; Industrial and Commercial Bank (Incombank) – to fund industrial development; Bank for Investment and Development (BIDV) – to facilitate infrastructure projects; and Vietnamese Bank for Agriculture and Rural Development (Agribank) – to provide rural finance and support to commodities markets. It is currently unclear whether these SOCBs will change their respective areas of focus as banking sector reforms continue.

[1] For a discussion of findings from the trip regarding the economy of Vietnam, please see issue number 2008-07 of the FRBSF Economic Letter (February 22): http://www.frbsf.org/publications/economics/letter/2008/el2008-07.html

As part of the latest round of banking sector reform measures announced in May 2006, SBV's ownership of the SOCBs will be reduced through the equitization (or sale) of bank shares. Under this effort, all SOCBs are to be equitized and the government share of these entities is to be capped at 51 percent by 2010, when foreign banks are slated to gain national treatment under Vietnam's WTO agreement. The first SOCB to be partially equitized was Vietcombank; although talks with foreign strategic investors fell through due to differences over share price, the government kept to its schedule and held an initial public offering of Vietcombank shares in late December 2007. Altogether the government sold 97.5 million shares or about a 6.5 percent stake in the bank, raising 10.5 trillion dong (approximately US$ 667 million). An additional 20 percent share in the bank is expected to be sold this year, underscoring the government's commitment to the equitization process.

In addition to the SOCBs, there are 37 JSCBs, accounting for roughly 15 percent of banking sector assets in Vietnam. Privately or semi-privately owned, these banks are significantly smaller than the SOCBs, but are growing rapidly. Their operations generally are concentrated in the major urban areas. They specialize in providing credit to smaller sized companies and retail finance, and have been quicker to adopt new technologies.

The three largest JSCBs are Asia Commercial Bank (ACB), Saigon Thong Tin Commercial Bank (Sacombank) and Vietnam Technological and Commercial Bank (Techcombank); together these three account for roughly one-third of the total banking assets held by the JSCBs. Free from the legacy of lending to SOEs, the JSCBs are generally considered better managed and are more profitable than SOCBs.

Foreign banking presence still limited

Foreign banks--through their branches, wholly-owned subsidiary banks, and joint-venture banks--currently account for 10 percent of Vietnam's banking market. The treatment of foreign banks varies depending on their country of origin, with U.S. and EU banks enjoying the most favored regulatory treatment due to the respective bilateral trade agreements. Currently, there are three U.S. chartered banks with banking operations in Vietnam (Citibank, JP Morgan Chase and Far East National Bank) with a combined total of roughly US$800 million in assets. Since April 1, 2007, foreign banks have been allowed to establish 100 percent foreign-invested subsidiary banks. As Vietnamese legal entities, these subsidiary banks will receive national treatment including permission to take unlimited local currency deposits from corporate borrowers and to issue credit cards.

Table 1: Disclosed Foreign Investment in Vietnam's Banking Sector

Source: Various English language sources including news articles (through December 2007) investment bank and rating agency reports.

Vietnamese Bank	Asset Size in US$ million (as of 12/31/06)	Foreign Investor	Initial Investment in US$ million (Date)	Current % Ownership
Asia Commercial Bank	$2,901	Standard Chartered IFC Jardine Matheson Dragon Capital	$22 (Jun-05) $ 3 (Dec-02) $ 2 (Jan-97) $ 2 (Jan-97)	9% 7% 7% 7%
Sacombank	$1,609	ANZ Banking Group IFC Dragon Capital	$27 (Mar-05) $ 3 (Oct-02) $ 3 (Oct-02)	10% 8% 7%
Techcombank	$1,126	HSBC	$17 (Dec-05)	15%
Habubank	$985	Deutsche Bank	N/A (Pending)	10%
East Asia Commercial Bank	$864	Citigroup	$35 (Pending)	10%
Southern Commercial Bank	$663	United Overseas Bank	N/A (Jan-07)	10%
VP Bank	$660	Overseas Chinese Banking Corp.	$16 (Mar-06)	10%
Oricom Bank	$419	BNP Paribas	N/A (Pending)	10%

Currently, the maximum ownership a single foreign strategic investor can take in a Vietnamese domestic bank is limited to 15 percent and total foreign investment cannot exceed 30 percent. Additionally, non-bank foreign investors that do not qualify as a strategic investor can invest only up to a 5 percent stake in a Vietnamese bank. The government allows only banks with at least 1 trillion dong (approximately US$64 million) in registered capital to sell shares to foreigners. This requirement limits the pool of eligible banks to about eighteen. So far about eight Vietnamese banks, excluding Vietcombank, have some level of foreign investment (see Table 1). Neither the source nor level of foreign investment in Vietcombank has been disclosed yet.

Working to improve asset quality and banking supervision

The government is working to resolve the banks' large portfolio of nonperforming loans (NPLs), tighten loan classification standards, ensure appropriate provisioning against loan losses, and increase capital to meet internationally accepted minima. Between 2001 and 2005, the government invested roughly 10 trillion dong (about US$ 635 million) to recapitalize the banks and encouraged them to establish their own asset management companies (AMCs) to facilitate NPL disposal. Market analysts have been skeptical, however, about the officially reported NPL levels, suggesting that the true ratios in the state banks range between 15 to 30 percent, well above the reported ratios of one to three percent as of year-end 2006. Moreover, rapid growth in retail and real estate lending, as well as direct and indirect credit for stock purchases, suggest a possible build-up of NPLs.

Market observers see an inherent conflict of interest in combining both the ownership and supervision of the state banks in one agency – namely the SBV – with negative implications for a strong supervisory regime. Importantly, management of the SOCBs will pass at some point from the SBV to the State Capital Investment Corporation (SCIC), Vietnam's holding company for equitized entities, which will remove the SBV from daily control of the banks. In addition, the government is drafting legislation that will be finalized in late 2008 or 2009 to make the SBV more independent, including a reorganization of banking supervisory responsibilities. In the meantime, Vietnamese authorities continue to focus on further strengthening supervision and improving banks' efforts to comply with regulations.

Much change ahead

Similar to China, the reform process has left Vietnam with the challenges of reforming a banking system dominated by SOCBs and managing legacy problem credits to SOEs. Over the next several years, the landscape of the Vietnamese banking sector is expected to change considerably as the Vietnamese government proceeds with the equitization of the SOCBs by 2010. Moreover, further financial liberalization under Vietnam's WTO commitments will allow greater foreign bank participation in the marketplace. How these changes will affect the Vietnamese banking sector remains unclear. Like other emerging economies, Vietnam must develop a deeper pool of banking executives with management experience and the critical infrastructure – such as credit bureaus, management information systems, and standardized accounting practices – that serve as necessary underpinnings to effective risk management. Rapid change will also present new challenges to effective bank supervision, which serves as the last defense against bank failures and other financial disruptions. These challenges notwithstanding, Vietnamese officials are cognizant of the challenges ahead and examining closely the experiences of their Asian neighbors for lessons to be learned. Of course, each country is unique and while comparisons to China and Thailand are frequent, Vietnam will be forging its own path forward.

*Exchange rate of VND 15,736 to US$1 (as of 12/31/07).

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