# Vietnam - Banking sector developments[1]

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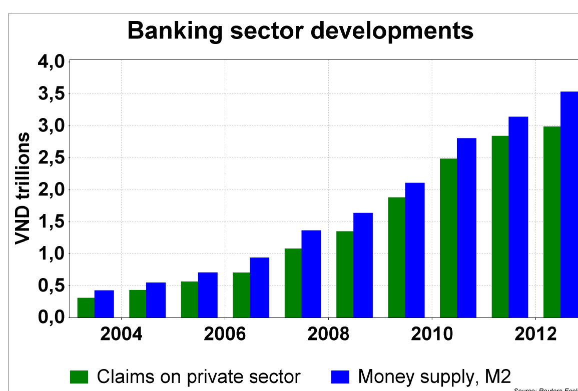
## *Special issue: The banking sector*

**Banking sector woes continue**: The torrent bank lending for almost a decade with total credits expanding at an annual rate 33%, came to a sudden stop in 2012 when it had reached 125% of GDP, at par with some much more advanced countries. In the first 11 months of 2013, credits expanded by 7,5%, short of the government's whole year's target of 12%. While a slowdown was not undesired, the abrupt change could raise concerns about the profitability of the banking system which is heavily (80%) dependent on interest margins, likely to be squeezed during a slowdown. Such concerns are exasperated by the risk that non-performing loans (NPL) might begin to grow faster with the seasoning of credits that were extended under a different set of macroeconomics and future prospects. That refers in particular to loans from state-owned commercial banks to state-owned enterprises related to non-core activities of the latter in real estate, the hospitality business and land-acquisitions.




**VAMC – a novel approach to bank rescue**: Bank rescues normally involve substantial government contributions to the recapitalization of banks and transfer of bad-loans to government supported "asset management companies" meant to give banks a "clean sheet". Vietnam has taken another route which essentially forces banks to pay for own mistakes. Vietnam Asset Management Company was established in June 2013 with the aim to purchase bade loans from the banks in return for government guaranteed zero-yield bonds. However, these bonds have to be written down within 5 years. (Technically, the banks have to make provisions for NPLs sold to VAMC at an annual rate of 20%.)[2] While this approach has the advantage not to burden the state and ultimately the tax payer it is seldom pursued lest banks in the meantime are paralyzed by low (or even negative) profits net of provisioning and thus left unable to restart normal credit

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[1] This report is based on publicly available information and information gathered during a recent trip to Hanoi and HCM City that included meeting with officials, academics and representatives of banks and the local business community.

[2] According to SBV representatives it is not yet decided what should happen to the bad loans in the hands of VAMC after the 5-years holding period. This is probably pending clarification to the legal issue of selling state assets below book value.

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intermediation. To mitigate that objection, Vietnamese banks will be allowed to use 70% of these bonds as collateral for short term liquidity assistance from the SBV.

**How big is the problem?** Last year VAMC bought VND35 trillions ($1,6 bn) of NPLs from banks and is supposed to buy at least four times that amount before the program ends in 2016, leaving the VND with a balance of VND175 trillions. That is more than 4% of total bank loans to non-government clients indicating that the level of NPLs in the banking system last June exceeded 7% because VAMC buys only the excess of 3% from banks. 7% is clearly greater than the reported average level of NPLs at 4,6% as of last June. That should be of little surprise to the rating agencies and other observers who have claimed that the true level of bad loans could be a multiple of times higher than reported if also restructured loans and other "special mention loans" are included as is the norm in most countries. 7%, however, is in line with estimates of Moody's (the rating agency) for the total by year-end of 2012.[3] While underreporting of bad loans is a general problem with banks in many countries, in Vietnam also regulations may give scant incentives to more complete reporting. That includes the ban on new branches or dividend payments as reconfirmed by SBV last December if provisioning is judged inadequate relative the level of NPLs.[4]

**Regulatory forbearance**: Vietnamese reporting standards could be subject to much regulatory forbearance. Only recently were banks permitted to report a part of the defaulted $4 bn. loan of the state owned company Vinashin as non-performing. According to estimates by the rating agency Standard and Poor's, the amount of bad loans could mount to 30- 50% of the total in a reasonable bad case scenario.

**Circular 02:** In early 2013, SBV issued an important and comprehensive document, Circular 02, to provide banks with a framework for new accounting and reporting standards including for bad loans and with the aim to improve transparency and regulate interconnectedness with other banks and clients. The new guidelines seek to

- widen the coverage and thereby bring definition of non-performing loans and assets closer to international standards,
- tighten regulations on "single borrower limits" by including also investment in debt securities issued by a bank client
- prevent inconsistencies of risk classification of clients among banks,

That said, Circular 02 also contains clauses that give the discretion to the government to assign special status to special cases allowing banks to avoid recognizing delinquencies such as Vinashin.

**Frosting on the cake?** It is now paramount Vietnamese banks produce enough profits to write off bad loans as they already start from a weak loss absorption capacity of less than 9% equity to assets (risk weighted). Further macroeconomic stabilization may come in handy in this context. Last year the placing of savings in bank deposits regained new attractiveness among the public as the exchange rate stabilized and the dollar deposits yielded only a fraction of dong deposits. At the same time neither the stock nor the property markets presented favourable alternatives. As a result, banks' cash balances swelled and many of them placed this liquidity in government bonds. As lower interest rates boosted their value, many banks made a decent profit from revaluation of bond portfolios. Further disinflation cum rate cuts could mean more of the same in 2014. It is noted, however, that while this may have benefitted the larger banks which traditionally are the most liquid, smaller banks depend on interbank

[3] (Problem loans+special mention loans)/Gross loans

[4] http://www.thanhniennews.com/business/no-dividends-without-debt-provision-vietnam-central-bank-to-banks-466.html

funding and have probably not been able to invest as much in a rising bond market.

**At the end of the day all comes down to reforms**: Relieving banks of past sins by bailing out bad loans in one way or another may not only prove futile but even make things worse if not combined with immediate reforms to change banks' incentives. Of the four large state owned commercial banks (SOCB) counting for almost half of the total banking system, only Agribank is yet to be equitized. Two of the others are already listed and have even attracted foreign investors to the upper limit of 30% of equity. BIDV, the second largest SOCB, is planning an IPO and listing in the near future. Private sector banks, by contrast, are much smaller but also more numerous with the total reduced to about 40 after a couple of them were merged in recent years – normally under SBV tutelage.

**Interconnectedness**: Like the SOCBs, also private banks are riddled with interconnectedness through cross-holdings and otherwise among banks and between banks and their clients. This can thwart motivations and further cloud an intransparent business environment. In 2013, SBV made an attempt to introduce forceful measures to fight such and other risky behaviour by issuing new guidelines -- "Circular 02" -- to this effect (conf. box above). However, having, reportedly met numerous objections from banks SBV postponed implementation for 12 months and recently pushed that back by another 6 months to early 2015.

Latest: Bloomberg News reported April 22, 2014, that Vietnam's Asset Managament Company aims to start selling bad debt from banks. That could mark an important milestone if that means it would also be able to sell bad debts originating from SOEs at market prices below book value.

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