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FINANCIAL SECTOR ASSESSMENT

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THE WORLD BANK

A joint mission from the World Bank (WB) and the International Monetary Fund (IMF) visited Vietnam in October 2012 and January 2013 to conduct the assessment of the Vietnamese financial system under the Financial Sector Assessment Program (FSAP)[1]. This report summarizes the main findings of the mission, identifies key financial sector vulnerabilities and developmental challenges, and provides policy recommendations for the further and sound development of the Vietnamese financial system. The report is based on the legal and regulatory framework in force as of December 2012 and the statistical database available by the same date. It also reflects the extensive discussions with policy-makers, regulators, academics, and market participants conducted during the assessment.

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GLOSSARY

AMC	Asset management company
AML/CFT	Anti-money laundering/combating the financing of terrorism
BCP	Basel Core Principles for Effective Banking Supervision
BSA	Inspection and Supervision Authority
CAR	Capital adequacy ratio
CIC	Credit Information Center
CSD	Central Securities Depository
DATC	Debt and Asset Trading Company
DIV	Deposit Insurance Vietnam
FSAP	Financial Sector Assessment Program
FSI	Financial soundness indicators
HNX	Hanoi Stock Exchange
HSX	Ho Chi Minh Stock Exchange
HVSS	High-Value Settlement System
IAIS	International Association of Insurance Supervisors
IASB	International Accounting Standard Board
IBPS	Inter-Bank Payment System
ICP	Insurance Core Principles
ICR	Interest Coverage Ratio
IFRS	International Financial Reporting Standards
IOSCO	International Organization of Securities Commissions
IPO	Initial Public Offering
ISA	Insurance Supervisory Authority
JSB	Joint-stock bank
LVSS	Low-Value Settlement System
MFI	Micro-finance institution
MOF	Ministry of Finance
MOU	Memorandum of understanding
MTPL	Motor third party liability insurance
NPL	Non-performing loans
NPS	National Payments System
PCF	People’s Credit Fund
RTGS	Real-time gross settlement
SBV	State Bank of Vietnam
SME	Small- and medium-sized enterprises
SOCB	State-owned commercial bank
SOE	State-owned enterprise
SSC	State Securities Commission
SSF	Social Security Fund
SSS	Securities Settlement System
TARC	Transactions and Assets Registration Centre
VAS	Vietnam Accounting Standards
VBARD	Vietnam Bank for Agriculture and Rural Development
VBSP	Vietnam Bank for Social Policies
VDB	Vietnam Development Bank
VSD	Vietnam Securities Depository
WTO	World Trade Organization

I. Introduction and Summary of Main Recommendations

1. **Vietnam has achieved remarkable progress since the start of its transition from a centrally planned economy in the mid-1980s.** The Economic Renovation Policy (*Đổi Mới)* announced in December 1986 marked the transition from a centrally planned economy to a mixed economy with greater reliance on markets and increased participation of private financial and non-financial institutions. These reforms contributed to an impressive performance in the last two decades—since 1990 the annual GDP growth has exceed 7 percent and per capita income has increased three-fold.

2. **However, in recent years the Vietnamese economy has shown signs of corporate and financial distress, and weaker growth**. Several segments of the corporate sector exhibit poor performance and financial distress, and have affected the health of the banking system. Large state owned enterprises (SOEs) have defaulted on their obligations and several others appear to be overleveraged. The banking system has accumulated a significant amount of non-performing loans (NPLs), estimated conservatively at 12 percent of total loans at the end of 2012, and many small banks have experienced more serious liquidity and solvency problems in the same period, leading to interventions by the State Bank of Vietnam (SBV). The reduced lending capacity of the banking system is one of the factors that have contributed to a sharp slowdown of credit growth (Table 1).

3. **The weak performance of the financial sector is due to a complex array of institutional and regulatory factors**. These factors have included episodes of interference by central and local authorities on the investment and credit decisions of state owned enterprises (SOEs) and state owned commercial banks (SCOBs); inadequate governance structures and risk management capacity in these institutions; connected lending in several joint-stock banks (JSBs); weaknesses in financial infrastructure, including poor financial reporting standards; and deficiencies in financial regulation and supervision. In this context, credit growth has often been excessive and credit allocation poor. Increased macroeconomic volatility in the last five years has compounded these problems and led to further deterioration in the quality of loan portfolios.

4. **The government has announced a comprehensive reform program designed to address the problems faced by the financial and corporate sectors.** The reform program was officially documented in the Socio-Economic Development Plan (SEDP) for the period 2011–2015, approved by the National Assembly in November 2011. It includes three basic components: banking restructuring, SOE restructuring, and public investment reform. Since then, the government and the SBV have been making efforts to elaborate further the design of these three programs, and in March 2012 issued a decision approving the banking restructuring component. More recently, the Government and the SBV introduced a new asset management company (the VAMC) to handle NPLs. The banking reform program is comprehensive, but important reform issues must be further developed and the program must be consistently implemented to ensure the full recovery of the financial sector.

5. **This FSAP provides a broad set of policy recommendations that can be used to operationalize the SEDP and the banking restructuring program.** The recommendations fall into three groups: (i) a plan to work out the large stock of existing NPLs; (ii) measures to ensure sound new flows of finance and prevent the accumulation of additional NPLs; and (iii) a set of policy steps designed to protect the financial sector during the envisaged reform period. For each group of measures, the plan identifies pre-conditions (first phase) and sub-sets of measures that needs to be implemented in the short run (second phase) as well as those that can be phased in over the medium term (third phase).

6. **The recommendations include recapitalization plans, the workout of NPLs, regulatory and other reforms, and the temporary extension of the safety net**. Special financial audits of banks would provide accurate assessments of NPLs, the related recapitalization needs, and key information for the design of debt resolution schemes. Operational audits would provide the basis for restructuring plans in the SOCBs. An identification of the main patterns of interconnectedness across banks and borrowers would allow the monitoring of systemic risk during the reform period. In a second phase, banks would be recapitalized and SOCBs and SOEs would divest their shares in other banks. This phase would also entail the preparation of a reform of the regulatory and supervisory systems. A well-articulated NPL workout program would be prepared in the second phase and fully launched in the third phase. It would proceed in four tracks, one led by the banks, one led by a centralized AMC, and two additional tracks to deal with large and complex SOEs. Simultaneously, a set of measures to relieve the SOCBs from policy mandates would be adopted. The implementation of the capital markets agenda and the reform of financial infrastructure and financial regulation would be deepened in this final phase.

II. The Structure of the Financial System

7. **The Vietnamese financial system is large for a low middle-income country, with assets of 200 percent of GDP in 2011.** As shown in Table 2, the banking sector dominates the financial system, with its assets amounting to about 183 percent of GDP (including the two policy banks) and 92 percent of financial institutions' assets. The banking sector is large by international comparison, whether measured by deposits or credits. As shown in Figure 1, bank deposits increased significantly in the past decade, reflecting a large savings ratio, rapid economic growth, and slower development of other suitable savings instruments. By 2011 the ratio of bank deposits to GDP exceeded the relevant benchmarks by significant margins[2]. The ratio of credit to GDP also expanded significantly in the same period, particularly from 2007 to 2010, driven by very high investment ratios, and also exceeded the relevant benchmarks by significant margins in the same period.

8. **While the financial system is large by international comparison, its expansion has been volatile in recent years, reflecting the unstable external environment and erratic macroeconomic policies**. As shown in Figure 1 and Table 1, the growth of credit has followed an erratic pattern since 2006, with credit spikes followed by sharp credit slowdowns. In 2007,

[2] The two benchmarks include: (1) the values predicted for Vietnam by a panel regression model that controls for per capita income, population size, population density and demographic profiles; and (2) the average of four East Asian countries (Indonesia, Malaysia, Philippines, and Thailand).

credit grew by 54 percent per annum (the equivalent of 20% of GDP), mainly driven by large inflows following Vietnam's accession to the World Trade Organization (WTO). Credit and economic activity slowed down at the end of 2008 as a result of the global crisis, prompting a corrective response from the authorities. The relaxation of fiscal and monetary policies triggered another credit spike in 2009 and 2010, prompting a round of policy tightening and a strong credit slowdown in 2011. Concerns that tightening was excessive amidst a weakening global environment prompted another aggressive loosening of policies in 2012, including cuts in policy rates and a range of administrative measures. However, credit growth has remained sluggish despite the policy easing, reflecting the deterioration of banks' balance sheets and the need for deleveraging. While the macroeconomic situation appears to have stabilized since 2012, financial vulnerabilities still need to be addressed by a coherent program.

9. **The banking sector is large, but non-banking financial institutions and securities markets remain small.** Non-banking financial institutions (including cooperatives) account for only 17 percent of GDP and 8 percent of financial institution assets. Finance companies provide project and consumer finance and represent the largest class of non-banking financial institution, accounting for 6 percent of GDP and 3 percent of financial institution assets. Insurance companies account for 4 percent of GDP, while mutual funds account for less than one percent of GDP and private pension funds remain negligible. The Social Security Fund (SSF) is the only institutional investor of significant size, managing pension reserves amounting to 6.5 percent of GDP. Equity markets have grown rapidly but are still at an early stage of development. While the number of companies listed in the two exchanges has increased dramatically, primarily due to the "equitization" of SOEs, total equity market capitalization is relatively small at 20 percent of GDP in 2011, reflecting the fact that listed firms in Vietnam are generally small. The fixed income market is of a moderate size and is dominated by government bonds.

III. The Structure and Performance of the Banking Sector

10. **State presence in the banking sector is large and involves both direct and indirect ownership links.** At the end of 2011, the five state-owned commercial banks (SOCBs) accounted for almost 40 percent of assets and 48 percent of deposits. The total participation of the State in the commercial banking system is larger, considering the equity participations of the state, SOEs and SCOBs in several of the 34 joint-stock banks (JSBs) – the segment that has grown most rapidly and accounts today for half of total assets. The share of foreign banks in total commercial banking assets has remained small and stable at 10 percent.[3]

11. **The banking system is also characterized by a high degree of cross-ownership between banks and between banks and enterprises.** This includes ownership of JSBs by other banks (both SCOBs and other JSBs) and by economic groups (including SOEs) whose structures are not well-understood. The complex shareholding structure raises serious concerns about conflicts of interest and related/connected party lending to finance questionable projects. These structures have also led to an overstatement of capital through multiple gearing and facilitated the circumvention of prudential regulations, such as credit concentration limits.

[3] The participation of the State in the banking system is even larger considering the two development banks – the Vietnam Development Bank (VDB) and Vietnam Bank for Social Policies (VBSP).

12. **The performance of the banking sector has deteriorated in recent years and is probably weaker than reported.** The average ROA of all banks fell from 1.8 percent in 2007 to 0.5 percent in 2012, with the latter figure probably overstated given the low quality of financial data. More generally, the low quality of financial data impairs the accurate measurement of most performance indicators, including ROAs, NPL ratios, and capital ratios. Data weaknesses are due to several factors, including inadequate loan classification and provisioning rules (including the classification of rescheduled loans), unreliable valuation of collateral and questionable classification of certain assets as liquid. In addition, there are concerns about the valuation of the large non-lending assets in banks' balance sheets, especially the inadequate valuation of investments (some of which related to operations designed to under-report NPLs) and lack of transparency over other items such as receivables. As mentioned before, there is also concern about multiple gearing of capital in light of the widespread cross-ownership.

13. **There are severe concerns about the quality of loan portfolios and the levels of capital in a number of banks.** Taking into account data weaknesses discussed above, the reported financial data was adjusted based on assumptions that are not too stringent[4]. These adjustments raised the NPL ratio to 12 percent at the end of 2012 and significantly lowered the capital-adequacy ratios (CARs) of several banks. Stress tests on the adjusted data further reveal that banks are highly exposed to credit and concentration risk. Sensitivity analysis to changes in assumptions shows that the key findings are robust, although the low quality of financial data and the need to rely on assumptions for several calculations mean that the stress test estimates are subject to wide confidence intervals.

14. **A complementary analysis of the listed corporate sector provided consistent results.** Many economic sectors are performing poorly, with the construction and materials, real estate, basic resources and utilities industries in particular vulnerable to economic shocks. Interestingly, although listed SOEs probably represent the best performing segment of the SOE sector, they still appear to be more distressed than their private listed counterparts. The underlying credit quality of majority state-owned companies is weak, particularly for the large enterprises. These firms could have difficulties in servicing their debts compared to private firms, as they are more indebted, have weaker liquidity positions, and are concentrated in the low-performing industries.

IV. Capital Market Development

A. Securities Markets

15. **The domestic fixed-income market is of a moderate size and dominated by government bonds.** The outstanding value of fixed-income securities is 15 percent of GDP, with almost 90 percent of the market consisting of government bonds (comprising treasury bonds, government guaranteed bonds and a small share of bonds issued by local authorities). Government bonds are frequently issued with tenors of three and five years, and the average maturity of central government debt is 3.2 years. The corporate fixed-income market has been growing but remains at an embryonic stage.

[4] The adjustments included the reclassification of loans in the top categories, haircuts of the inferred levels of collateral and further adjustments to reflect the likely overvaluation of investments and other assets.

16. **The MOF has taken important initial steps towards the development of the government debt market, but much needs to be done to build a reliable benchmark yield curve.** Factors limiting bond market development include ineffective primary markets (despite recent commendable initiatives and improvements, there is still an excessive number of issues, no critical mass of issues in the main benchmarks, and the new primary dealer system remains untested); illiquid secondary markets; the absence of a solid institutional investor base (banks hold more than 80 percent of the stock of domestic government debt); and the absence of the necessary infrastructure and market support services.

17. **The government has recently approved a comprehensive roadmap for bond market development and a timeframe for implementation.** The roadmap is based on five pillars, including the policy framework, primary market, secondary market, investor base, infrastructure, and support market services. The government is establishing a committee to implement the roadmap over the remainder of the decade, chaired by the MOF with the participation of the SBV and other relevant stakeholders. The roadmap is focused on the government bond market, but its implementation is a precondition for the sound development of the corporate bond market. These efforts are commendable, given the potential contribution of corporate, infrastructure, and covered bonds for expanding access to long-term finance by corporates, local governments, and banks, while also contributing to the stability of the financial system.

18. **The equity market is characterized by a large number of listed companies with low average capitalization.** The two exchanges, the Ho Chi Minh and Hanoi Stock Exchanges opened trading in 2000 and 2005 respectively, and already have 700 listed companies, an unusually large number for Vietnam's level of income and young capital markets. The rapid increase in listings was due primarily to the "equitization" of former SOEs through initial public offerings (IPOs). About one-third of the companies listed are majority state-owned. The Ho Chi Minh City Stock Exchange (HSX) is the principal equity market for larger companies and listed 302 companies and 6 closed end funds as of end 2011. The Hanoi Stock Exchange (HNX) is the primary fixed income market, operates an equities market listing 396 companies (typically smaller in size than HSX listed companies) and also hosts the UpCom platform where 135 non-listed public companies are traded. Despite the creation of UpCom, the shares of many public companies continue to be traded outside regulated markets.

19. **While the equity market has so far served as a conduit for "equitization", it has the potential to play a much more meaningful role.** Total market capitalization was about 20% of GDP in 2011, roughly in line with the levels predicted for Vietnam but significantly lower than comparable East Asian markets (Figure 1). The fact that market capitalization is relatively small despite the large number of listings reflects the small size of most listed companies. Many of the SOEs with better prospects have not yet listed and family companies may still be reluctant to commit to enhanced disclosure. The universe and quality of listed firms could be improved by equitizing some of the larger companies with better prospects and seeking strategic investors to improve governance and performance. Market depth, liquidity, and price discovery can also be improved by enforcing the processes that require public offers to be listed on the public market, and building the investor base. The institutional investor base in Vietnam is very thin, and the prevalence of retail investors raises questions about the quality of price discovery. From a customer protection perspective, reliable disclosure, control of related party transactions, protection of customer funds, and the financial integrity of firms handling trading are concerns.

B. Institutional Investors

20. **The small mutual fund industry shows promising prospects for growth, but it is critical to improve certainty about the legal framework and build market confidence.** Until recently, the industry was restricted to 23 closed-end funds managing assets of only 0.4 percent of GDP in 2011. However, new legislation enacted in December 2011 has already led to the offering of the first two open-ended funds in early 2013. Bond funds and index funds representing the VN30, an index of 30 HSX blue chips, are also in the planning stage. Related regulations appear comprehensive, but the valuation and distribution of units must be carefully monitored. As the funds distribution channel has been expanded beyond securities companies to banks and insurance companies, it is important that disclosures at the point of sale clarify that the investment is not a bank deposit or some type of insurance. Expanded investor education and financial literacy programs should accompany market development efforts. The valuation of fund portfolios should be scrutinized, especially considering the illiquidity of many market segments.

21. **The insurance sector is small and still dominated by the non-life sector.** At the end of 2011, there were 43 active insurance companies, including private and foreign players, but total assets were only 4 percent of GDP and industry premiums only 1.8 per cent of GDP in the same year. Non-life insurance is the largest portion of the insurance market (at 56 percent of premiums), with the main business line being motor insurance, including motor third party liability (MTPL). This segment may need to undergo a major restructuring program. Large numbers of cars and motorbikes are driven without insurance. Premium rates and insurance provisions do not reflect underlying risks and expected costs, as they are not based on the underlying risk characteristics and statistical data.

22. **Given the weight of Motor and MTPLs business, the Insurance Supervision Agency (ISA) should adopt risk based premiums and limit insurance fraud in motor vehicle insurance in general and MTPL in particular**. The introduction of risk-based premiums should be done across the entire insurance sector, starting with Motor and MTPL, while also guaranteeing the adequacy of premiums to ensure the industry's solvency. It is essential to combat fraud in MTPL, ensuring that insurance companies cooperate with police departments to reduce the number of the uninsured and improve driver behavior. Other obstacles in the development of the insurance sector include a weakly regulated and supervised environment, a dearth of actuarial skills and an insufficient volume of suitable instruments to support the long-term liabilities of the life sector.

23. **Bancassurance has started showing some growth, but its distributional advantages have yet to be effectively explored to reach untapped segments of the population.** Banks in Vietnam have extensive distribution networks through which insurance can readily be channeled. Thus, bancassurance provides substantial potential to increase the population's access to insurance products. However, there are also risks associated with giving banks undue levels of power in communities, so careful regulation and supervision is required to ensure the adequate protection of policyholders.

24. **Private pension funds are still negligible, but the Social Security Fund (SSF) has sizable assets and could contribute more effectively to capital market development**. The SSF manages sizable assets of about 6.5 percent of GDP, but does not have a well-articulated

investment policy, and its portfolio consists primarily of government bonds, bank deposits, and loans to SOCBs. While it is premature to introduce changes at the moment, given the vulnerabilities in the banking system, the SSF should consider adopting a new approach to the management of its reserves, in line with best international practice, once the banking system is fully restructured. This would include a well-articulated liability-driven investment policy, combined with decentralized asset management.

V. Financial Inclusion

A. Progress in Expanding Access to Finance

25. **Vietnam has made some progress in expanding access to finance, although there is still ample room for expanding access further.** The World Bank Findex survey data shows that Vietnam has a higher level of credit account penetration for SMEs and individual account holders than comparators, but data from the credit bureau and anecdotal evidence from discussions with market players suggest that the expansion of access could be overstated. In particular, the characterization of the multiple subsidiaries of SOEs and economic groups as SMEs could distort the extent of progress in SME finance. Furthermore, the World Bank-IFC's Enterprise Survey data show that firms characterize access to finance as a major constraint and collateral requirements in SME lending are at 218 percent of collateral-to-loan ratio, which is higher than most comparators. Deposit account penetration also lags comparator countries and the insurance sector is still small despite recent growth. The agriculture insurance program launched by the government remains a pilot. Lastly, the quality, range and depth of all financial services remains limited, with considerable potential for product refinement and development.

26. **Vietnam's approach to financial inclusion has relied prominently on the interventions of policy banks and a few SOCBs.** Policymakers have essentially relied on the two budget-funded policy banks – the Vietnam Bank for Social Policies (VBSP) and to a lesser extent the Vietnam Development Bank (VDB)[5] – but also the Vietnam Bank for Agriculture and Rural Development (VBARD), for promoting the financial inclusion agenda. Price controls have been a prevailing feature, and budgetary support to the VBSP (and the VDB) has enabled the VBSP to offer under-market interest rate products to its low-income clients in line with its mandate. In rural areas, VBSP and VBARD dominate the provision of credit.

27. **Further progress in financial inclusion will require further strengthening of financial infrastructure, institutional reforms and product market development.** Improvements in infrastructure would enhance the incentives for broader participation. The authorities could consider the development of reliable financial reporting standards for SMEs that balance transparency and simplicity. The IFRS for SMEs would provide a good starting point. The CIC should expand coverage of data from PCFs, MFIs and the VBSP. The operationalization of the new credit bureau could enhance competition and improve services for users. The secured lending framework should be strengthened as discussed below. The design of the SME Guarantee Fund of the VDB should be revised to enhance outreach and additionality. Lesser use of price controls[6] would also help to remove market distortions and potential

[5] The VDB receives small postal savings, channeled to project finance.

[6] The literature on financial inclusion indicates that price controls can lead to market distortions and credit rationing, and are ultimately inefficient for the financially underserved segments they were meant to protect.

disincentives for broader participation. Weaknesses in several key institutions have to be addressed, including the PCFs (low capital adequacy, weak profitability and liquidity concerns) and the two policy banks. The VBSP should be restructured to reduce reliance on budget support and offer financial products on market-based conditions. Further effort is also required in product market development, in particular savings promotion and agriculture finance.

B. Developments in Housing Finance

28. **Real estate lending reflected significant boom-bust behavior in the past few years, but affordable housing remains short in supply.** Prior to 2010, there was a period of substantial market overheating, and the SBV responded by instructing banks[7] to reduce the growth rate and share of real estate loans. This decision, as well as the subsequent downturn, led to a sharp decline in lending activity. While condominiums, higher-end housing and office spaces are in surplus, affordable housing is in short supply. The Government launched a stimulus program in January 2013 requiring state-owned commercial banks to allocate at least 3 percent of the loan portfolio to lending to low income households and public servants, as well to developers supporting the conversion of higher-end properties to affordable housing.

29. **The legal infrastructure is not a significant source of concern but the enforcement of mortgage rights is a cumbersome and lengthy judicial process**. The registration system works fairly well, despite some reported problems at the provincial level; transaction costs are reasonable, and a computerization process has been initiated. Enforcement of mortgage rights typically takes two years, and the eviction of defaulting borrowers is difficult in the case of residential properties, although it seems to play a coercive role by facilitating voluntary workout solutions. The banking law allows banks to keep repossessed properties for up to three years, a reasonable time frame for disposal in normal market conditions.

30. **Other sources of vulnerability include the lack of information, certain lending practices for retail housing loans, and liquidity mismatches.** The lack of well-organized data on transactions and no official price index makes it difficult to value real estate collateral. There are also inconsistencies in the reported data – the actual impact of the crisis is not reflected in the reported performance of the banking system, and the sector has probably contributed significantly to the build-up of NPLs. Affordability criteria are lax, and given the variability and historical volatility of interest rates, this translates to a latent credit risk that would materialize in case of new interest rate surges. There are also duration mismatches – mortgage lenders do not have access to long term funding, besides loans provided by the government or SBV.

31. **The government and the SBV should consider several steps to ensure that housing finance develops on a sound basis.** The transparency of the real estate market can be improved by developing price indices, strengthening housing demand analyses, monitoring the supply, and creating indicators of market equilibrium such as on-going and future delivery of new units, vacancy rates, and sales of new developments. Guidelines for appraising underlying assets should also be set, as well as stronger expertise requirements for appraisal. Creating mortgage lending databases would improve critical information to supervisors, enable tracking of new

[7] Commercial banks are the dominant players and have limited product diversification.

lending by vintages, and the monitoring of loan-to-value (LTV) ratios, debt service-to-income ratios, and NPLs by annual cohorts.

32. **Other measures include strengthening the prudential framework, developing a consumer protection framework and introducing long-term funding instruments.** Prudential rules should be designed for commercial real estate and developer finance. In particular, lending to developers should be linked to the volume of pre-sale contracts, which is an indicator of the adequacy of new developments to demand. Regulators should also prepare a set of counter-cyclical prudential measures by adjusting parameters such as LTV limits, risk weights of differentiated types of loans, or provisioning requirements. Stress tests at origination for floating rate loans should also be required from lenders as well as periodic updates to assess the impact of shocks. Measuring affordability based on initial "teaser" rates should be prohibited. Developing a consumer protection framework would reduce mis-selling and enable households to make better decisions. Finally, introducing long-term funding from capital markets will not only improve the liquidity balance of the banking system but also mitigate the credit risk derived from the interest rate risk borne by borrowers, by offering more fixed-rate solutions.

VI. Financial Infrastructure

A. Accounting and Auditing

33. **Financial reporting in Vietnam needs a significant revamp in order to enhance its reliability and usefulness for investment, management, and monitoring purposes.** The accounting framework (Vietnamese Accounting Standards, or VAS) was mainly established in 2003 by the Law on Accounting using as a reference the International Accounting Standard Board (IASB) framework applicable at the time, but substantial differences exist between the two sets of standards. VAS tends to overstate profitability, asset values and the solvency situation of reporting entities. At present only a few foreign institutions, including foreign-owned banks, are presenting their accounts based on IFRS (in addition to VAS-based statements).

34. **The problems embedded in VAS are exacerbated by the incipient nature of accounting and auditing, and the absence of a culture of transparency and accountability.** There is a lack of well-trained accountants to prepare reliable financial statements. In addition, while the recently enacted Independent Audit Law of 2011 could provide the legal basis for the establishment of a reliable auditing profession, its actual implementation will require a strong political commitment that to date remains elusive. There is lack of enforcement of VAS and limited disciplinary action against practitioners who have not implemented VAS or the Vietnamese Standards in Auditing in accordance with the regulation.[8]

35. **Financial statements are generally opaque, especially regarding SOEs, and the quality of financial reporting by financial institutions is also generally poor.** In the case of SOEs, the weaknesses in VAS are aggravated by supplemental MOF accounting rules against "the loss of state capital", that hinder recognition of losses and mask the weak performance of several SOEs. The quality of financial reporting by financial institutions varies widely among

[8] In response to these deficiencies, on September 2013 the Government issued a Decree prescribing sanctions for violations of accounting and auditing rules, but the Decree and its implementation were not assessed by the FSAP.

types of institutions, but it is generally poor, especially among SCOBs. Moreover, the financial supervision function remains weak (Section VII) and does not contribute effectively to improvements in the quality of financial reporting of the supervised entities.

B. Credit Reporting

36. **The Credit Information Centre (CIC) plays a relevant role in the flow of credit information, but significant operational and regulatory gaps still exist**. The CIC holds 23 million records on individuals (around 30 percent of the adult population) and 500,000 firms as of 2011. All regulated financial institutions are mandated to report to the CIC. A credit bureau created in 2007 by eleven banks was only issued its license in March 2013. Numerous gaps still hinder the effectiveness of credit reporting. First, financial institutions basing adverse credit decisions on CIC information cannot disclose this fact to potential borrowers. Second, effective enforcement mechanisms are not in place ensuring timely updates and data quality to the CIC. Third, the BSA commendably has real-time access to the CIC database, but the CIC no longer provides periodic reports of supervisory value. And fourth, only financial institutions are to date participants in the CIC system. Extending participation to other types of entities with relevant data would broaden and deepen the CIC's database, which would enable SMEs in good standing with non-financial creditors to obtain loans on better terms. Finally there is a need to ensure adequate oversight of the overall credit reporting system (CRS). Therefore, authorities should consider the role of the Central Bank as primary overseer of the CRS supporting the development of efficient, safe and reliable credit bureaus while ensuring the efficiency of the CIC. Also, regulators should encourage the development of the new licensed credit bureau as a complementary and important source of credit information.

C. Creditor Rights and Insolvency

37. **There are serious gaps in the law and practice of the secured lending framework.** The legal framework is fragmented and internally inconsistent. Foreign entities are unable to effectively take security over land use rights (as Vietnam does not allow foreigners to own land)**.** The land register is beset with problems: it is paper-based and its utility is undermined by many factors, including the difficulty to search the name of registered proprietors, the low quality of publicly available information, and incomplete procedures governing land use certificates, especially in urban areas.[9] The National Registration Agency of Secured Transactions, which registers security interests in movable assets, generally works well, but market participants have raised questions about the system's reliability and security.

38. **The procedures for the enforcement of claims are dysfunctional, and disposal of encumbered assets is lengthy and difficult.** There are problems with both the seizure of the debtor's assets and their disposal. For unsecured claims, creditors are not entitled to unilaterally seize their debtor's assets. As there is no fast-track court procedure for simple debt collection cases, sophisticated debtors use these weaknesses to strategically delay cases. As regards secured claims, the legal entitlement of the creditor to unilaterally seize the secured assets is unclear, and it seems impossible in practical terms to seize a land use right where the relevant property is a

[9] A Circular No. 04/2013/TT-BTNMT issued in April 24, 2013 provides for certain improvements in this area.

residence. Thus, in both cases lenders must resort to the often inefficient court system. While encumbered assets may be sold privately, conducting a private sale without the debtor's cooperation is very difficult. Secured assets may be sold through auction, but this often takes too long and can thus be value-destructive.

39. **The enterprise bankruptcy system is dysfunctional, and many commercial courts do not attract public confidence.** The bankruptcy code is modern and provides for both liquidation and restructuring, but remains ineffective. There are very few bankruptcy cases in practice due to the stigma in the bankruptcy process and lack of confidence in many courts. Stakeholders avoid insolvency proceedings which results in the majority of cases being resolved in an informal way, whereby debtors' assets are subject to multiple transfers, rendering them hard to trace. There are also concerns about political influence, insufficient expertise, significant delays and strategic misuse of the court system. The Supreme People's Court prepared a new bankruptcy law designed to address some of these deficiencies consistently with international best practice, and the law was recently passed by the National Assembly. However, efforts will still need to be made to address how the law is used in practice.

D. Payments and Settlements Systems

40. **Over the past decade, the State Bank of Vietnam (SBV) and the State Securities Commission (SSC) have initiated a major reform of the National Payments System (NPS).** Such reform included the launch of new and modern system applications – the Inter Bank Payment System (IBPS) in 2002 which was upgraded in 2008; as well as legal and regulatory reforms. The role of the SBV with regards to payment and settlement systems was revamped, in particular through the adoption of the SBV law in 2010 and various circulars and decisions. For the supervision and regulation of the securities market, the role of the SSC was revamped through the issuance of the 2006 securities markets law (and amendments in 2010). The systemically important financial market infrastructure (FMI) currently operating in Vietnam[10] includes the IBPS, the Vietnam Securities Depository (VSD), SBV Securities Depository and the Vietcom Bank foreign exchange settlement system. In Vietnam there is currently no process for formal designation of specific FMIs as systemically important. The Vietnam Securities Depository operates a delivery-versus-payment securities settlement system for securities traded at the two stock exchanges. The SSC and the VSD have appointed BIDV as the settlement bank for the cash leg of securities transactions. The VSD has established a fund (Compensation Fund) to guarantee the settlement and some clearing members have pre-agreed credit lines with the BIDV.

41. **While the reform efforts are commendable, there is still ample scope for improvements in the general organization of IBPS and the roles of the authorities[11]**. The legal framework has gaps due to which finality and irrevocability of transactions; protection of ownership rights of collateral placed for liquidity support; and recognition and protection of procedures like netting, are addressed at the level of operating rules but not addressed adequately in primary legislation. Although the IBPS has elements of risk management, there is no comprehensive risk management framework, resulting in several issues of concern in the areas of

[10] In this FSAP only the IBPS was studied in detailed and assessed against the CPSS-IOSCO PFMIs.
[11] Based on the assessment against the CPSS-IOSCO PFMIs.

credit risk, liquidity risk, operational risk and risks arising from the tiered membership structure. The current scope and powers of authorities with respect to FMIs are ambiguous, and should be clarified and strengthened. The SBV and SSC's policy objectives with respect to regulation, supervision and oversight of FMIs are not articulated, and their powers not explicitly mentioned in the legal framework. The authorities should start implementing CPSS-IOSCO Principles for Financial Market Infrastructures (PFMIs) and consider undertaking a formal evaluation of the staffing and skills levels with respect to the oversight activities. Lastly, the SBV and the MOF should leverage the existing MoU to develop mechanisms for on-going cooperative oversight. In addition, a number of market-wide recommendations have been identified. The VSD and Vietcombank Foreign Currency Settlement system could also be considered systemically important FMIs and as such the PFMIs should be applied to them as well. The SSC and the SBV should consider conducting a detailed analysis of the costs and benefits of having a CCP as part of their oversight activities. The lack of a direct debit system is a significant gap in the retail payments infrastructure; the SBV in co-ordination with the other stakeholders should address this gap in the medium-term.

VII. The Regulatory and Supervisory Framework

42. **The regulatory and supervisory framework needs to be substantially strengthened to ensure a sound path to financial development in the remainder of the decade.** The regulatory and supervisory framework, although full-fledged, is divided among multiple agencies. The SBV through its BSA, supervises credit institutions, while the insurance sector and securities markets are supervised by the MOF through the ISA and the SSC. All supervisory agencies suffer from limited operational independence. Moreover, each agency focuses on its sector and does not conduct supervision of financial groups. Furthermore, supervisors have limited tools to identify the time series and cross-sectional dimensions of macro-prudential risk. A "too-interconnected-to-fail" structure is emerging as a result of gaps in the legal framework, inadequate enforcement and weak crisis management. There is no institution responsible for gauging and managing overall risks in the financial system, and no legal framework for macro-prudential policy. While the SBV has functional responsibility for systemic risk oversight, it lacks the database and the capacity to analyze emerging systemic risks.

A. Banking Regulation and Supervision

43. **Banking regulation and supervision are still under development and face substantial challenges.** The level of compliance with the Basel Core Principles (BCPs) is low. The combination of the prudential supervision function (focused on the safety and soundness of the banking system) and the "general inspectorate" function (focused on policing violations of administrative procedures) has undermined the core prudential supervision function performed by the SBV – on-site inspections of SOCBs by the SBV have not been conducted for several years, partly to avoid overlap with inspectorate visits by the General Inspectorate and State Audit Office. Off-site monitoring is still in its inception. There is very limited financial reporting and disclosure requirements for banks, the quality of information is poor, and non-financial disclosures are practically non-existent. The SBV does not perform consolidated supervision effectively and does not conduct effective oversight over entire banking groups. The regulatory framework contains some provisions related to cross-border banking supervision, but there are still significant supervisory gaps regarding the overseas operations of local banks.

44. **A number of factors inhibit the effective exercise of SBV powers.** The SBV has multiple objectives and its independence is limited, compromising the capacity of the supervisor to exercise the powers that are granted by legislation. On the positive side, Vietnam has an adequate framework regarding permissible activities, providing a base for appropriate coverage of regulatory framework over deposit-taking institutions.

45. **The effectiveness of supervision is also undermined by serious gaps in the regulatory framework.** First, the definition of related parties is overly narrow, hindering the identification and assessment of ultimate beneficiaries, and affecting various aspects of supervision, including licensing, transfer of ownership, acquisitions, large exposures, related party lending, and capital adequacy. Second, the licensing and authorization framework is too prescriptive and does not allow enough room for supervisors to conduct proper screening and assessment. Third, prudential regulations and requirements are still weak. Capital adequacy requirements are still based on Basel I and guidelines on market, operational, and interest rate risks are lacking. Fourth, asset classification and provisioning rules are ineffective.

46. **Laws and regulations give the supervisor broad remedial powers, but these are used sparingly and critical gaps still remain.** Although the legal framework provides broad enforcement powers, operational guidance and procedures for the use and escalation of the powers are lacking. In spite of the presence of several weak institutions, in the past decade no banks have been placed under special control of the SBV, due to concerns that doing so could cause a run. This reflects also the lack of a prompt corrective action framework that would force the supervisor to act in these circumstances. Finally, the SBV does not conduct consolidated supervision. While it has the authority to supervise banks and subsidiaries, it lacks powers to monitor parent and sister companies.

B. Bank Governance

47. **The state plays conflicting roles in the banking system, reducing the incentives for banks to take full responsibility and accountability for their business.** Policy mandates and directed lending, together with a weak regulatory and supervisory framework and low levels of transparency have created a business setting with little or no accountability for bank boards and management. SOCBs also suffer from the lack of well-defined governance structures, and some of the responsibilities normally assumed by a bank board are carried out by the SBV.

48. **The complex shareholding structure of many private banks raises concerns about conflicts of interest, particularly of imprudent channeling of funds to related parties or unrelated speculative ventures.** The financial system lacks a strong risk culture and risk management is underdeveloped across financial institutions. In addition, current laws and regulations focus on detailing the mechanics of each administrative body rather than charging the parties with responsibility to act in the best interests of the public trust and sector stakeholders. Critical pieces of regulation are absent, including a code of bank governance and risk management regulations.

C. Capital Markets Regulation and Supervision

49. **The SSC lacks sufficient powers, resources, and independence to be fully effective, and several legal and operational issues impair sound market development.** Commendable first generation reforms have been enacted, but their application has been inconsistent and second generation legislation is needed. The legal and accounting framework should be brought into compliance with international standards and the operational oversight practices should be strengthened. Consistent and predictable enforcement is necessary to increase confidence and foster trading in regulated venues. It is laudable that the cooperation between the banking and securities supervisors is being enhanced in order to address potential system-wide risks; however, it must be tested in practice. Further, as the distribution network for securities is expanded to banks, supervisors should be aware that risks migrate from one sector to another and miss-selling or misuse of customer funds can impair market confidence and development.

D. Insurance Regulation and Supervision

50. **The ISA faces significant supervisory challenges, is under-resourced and lacks operational independence.** Supervisory systems are not risk-based and standards in prudential areas, valuation, reinsurance, market conduct and group supervision need to be improved in order to ensure compliance with international standards. Supervisory resources are below the levels seen in comparable markets. The ISA would need to strengthen its financial resources, build technical capacity, and strengthen its information systems. The ISA is encouraged to implement a supervisory development plan around three pillars: (i) a modern, independent, and self-funded supervision model; (ii) introduction of much stronger governance structures and internal controls; (iii) introduction of a risk-based supervisory approach, along with prudential standards, valuation, reinsurance, market conduct and group supervision.

E. Financial Safety Net and NPL Resolution

51. **The DIV has responsibility for standard 'pay-box' duties, but the new law provides for a broader role.** The system extends coverage of Vietnamese dong deposits of up to VND50 million (less than US$2,500) although a higher level of coverage is being considered. Deposit-taking institutions must pay an annual deposit insurance premium equal currently to 0.15 percent of the average insured deposit balance. The number of staff is very large but not used effectively, and the agency expends most of its resources reviewing compliance with provisions of the law.

52. **The DIV has never been used for the resolution of NPLs or troubled banks, and has a weak financial position.** There is resistance to close and liquidate insolvent banks, ostensibly to avoid bank runs. However, should it be necessary to do so, the DIV's financial position is inadequate to assist even in the liquidation of two medium-sized institutions. Currently, the fund balance as a percentage of total deposits stands at approximately 0.8 percent. Also, there are serious risks in the way the DIV's funds are invested. The institution currently places the bulk of its investments with member institutions. This poses risks to the DIV's invested funds, if any of these institutions face a liquidity or solvency crisis.[12]

[12] The Law on Deposit Insurance enacted of 2012 allows the DIV to invest in government bonds, SBV bills and deposits at the SBV, but the FSAP did not assess the extent to which the DIV's investment policy has changed.

53. **The preferred method of resolution by the authorities has been the merger of financial institutions to address institutions with liquidity problems.** A primary reason for choosing the merger option is the tight fiscal position and the wish to avoid bank runs. Nevertheless, while mergers have addressed short-run liquidity problems, it is likely that they have not addressed the underlying asset, liquidity, capital and governance problems. Further, the capacity to undertake a purchase and assumption transaction (P&A) is not clear under the Credit Institution Law. A more effective bank resolution regime should be introduced and tested with a small institution.

54. **Since 2003, a centralized asset management company (the DATC) was created to reduce the level of NPLs in the system, but it has had minimal impact.** As of now, it is barely functioning and its remaining assets are concentrated in inventories, receivables and very illiquid investments in subsidiaries and joint ventures. The DATC purchases assets (until now approximately VND10 trillion) primarily from the SOEs. Banks are reluctant to use the DATC due to the reportedly low collection rate (approximately 28 percent of book value, net of expenses). AMCs set up within banks groups have not been very effective either.

55. **The establishment of a central Vietnam Asset Management Company (VAMC) has so far been the most visible step towards the resolution of the NPL problem.** In May 2013 the Government issued Decree 53 empowering the SBV to establish the VAMC with a charter capital of VND 500 billion (equivalent to US$24 million).[13] The VAMC is expected to buy bad debts from banks at book value (net of provisions) or at market prices. The purchase can be conducted with special zero interest bonds issued by the VAMC. The banks can use the VAMC bonds for refinancing loans through the SBV and are obliged to make annual provisions at a rate of not less than 20 percent of the value of the bond. At the time of the redemption of the special bonds, if the underlying debt has not been resolved the banks will repurchase debts from the VAMC at book value and return the special bonds to the VAMC. If a credit institution with more than 3 percent NPL ratio refuses to sell bad debts to the VAMC, the SBV can carry out an inspection or hire an independent audit to assess the quality and value of assets of those banks.

56. **The effectiveness of this NPL resolution strategy is questionable and a proactive multi-pronged approach may be required.** The resolution of NPLs through the VAMC will depend on its attractiveness to banks as well as its pro-activeness in addressing NPLs. The VAMC design requires banks to provision 20 percent per year against the VAMC bonds without giving them an earning asset (the AMC bonds that will be exchanged for the NPLs have a 0% coupon rate). The access to liquidity using AMC bonds may be of interest to only a handful of banks which are facing more severe liquidity constraints. Furthermore, if the assets are transferred and warehoused, with no active management or disposition, they may actually lose value over time. In any event, only part of the NPL stock will be addressed through the VAMC.

57. **The authorities may want to consider adopting a multi-track restructuring approach that would include four main inter-connected tracks**:

[13] The VAMC was created after the FSAP was submitted to the authorities on January, 30, 2013.

(i) ***Court-supervised insolvency track***, to address the distressed debt of complex and large groups. However, for this track to be effective, the enterprise bankruptcy regime needs to be overhauled to support formal liquidation and rehabilitation processes.
(ii) ***Bank-led restructuring track***, to be facilitated through primary legislation to establish a creditor-led, accelerated 'pre-packaged' plan negotiation and approval mechanism. The legislation should specify the minimum content of both the applicable negotiating procedure and of the plans to be negotiated, while leaving maximum discretion to the negotiating parties themselves;
(iii) ***Asset Management Company ('VAMC') track,*** which would take the lead in resolving non-performing loans/assets, especially in the construction/real estate sectors.
(iv) ***Special administrative restructuring track***, to be used in limited cases where all or almost all of an SOE's debts are with SOCBs. The Government could pursue an administrative solution for the NPLs, combined with specific SOE restructuring programs.

58. **Legal reforms are needed to support this multi-track approach.** To eliminate obstacles to voluntary workouts and claim enforcement, changes are needed to the Civil Code, Code of Civil Proceedings, Enterprise Law, Land Law, Law on Enforcement of Civil Judgments, the Decrees on Auctions and on Security Transactions, Government Decision 90/2011, the Tax Code, and SBV Decisions.

VIII. Strengthening the Government Reform Program

59. **The proposed reform agenda aims to address the fundamental challenges in the financial sector in three phases.** The two fundamental challenges include the effective resolution of a large stock of NPLs and ensuring the efficiency of the new flows of finance. Moreover, during the period of reform design and implementation it is essential to preserve the stability of the financial system to ensure the success of the program. The proposed financial reform agenda would be implemented in three main phases. Phase 1 would entail essential diagnostic work (such as special financial audits) preparing the ground for a successful financial reform. In phase 2 the government would launch the priority components of the program (including bank recapitalization) and finalize the design of the other components. In phase 3 the government would deepen and consolidate the implementation of the reform program. Table 3 provides a schematic summary of the three phases.

A. First Phase: Meeting the Pre-Conditions for a Successful Reform

60. **The most urgent reform measure entails special financial audits to measure NPLs accurately and operational audits on SOCBs.** Many successful financial reform programs were built on detailed financial and operational diagnostics. These audits would assess the quality of loan portfolios, the profile of borrowers, the types of collateral and their estimated values, and patterns of interconnectedness across banks and borrowers. The audit results would allow the government and the SBV to identify recapitalization needs and alternative funding sources, e.g. potential need for fiscal support and/or increased participation of strategic private investors in the case of SOCBs. State-owned banks would also be subject to special operational audits, which would include an assessment of governance structures, risk management functions, internal controls, IT systems, and HR policies and procedures. The operational audits would also

assess their capacity to lead debt workouts and enterprise restructuring. For the private joint-stock banks, their capacity to lead debt workouts should also be assessed.

61. **The first phase would include temporary measures to protect the stability of the financial system during the reform period.** This should include an extension of deposit guarantees and a well-targeted liquidity support facility.

B. Second Phase: Launching the Priority Components of the Reform Program

62. **The most important policy measure in this phase would entail the recapitalization of the banks deemed viable (based on special audit results) to regulatory minimums, and the orderly exit of unviable banks.** The recapitalization of SOCBs and private joint-stock banks would be accompanied by several additional measures. This includes the divestiture of shares in other banks, or transfer to the VAMC or SCIC for future divestiture, depending on market conditions. For SOCBs, a change in management should be considered, and an international advisor should be selected to implement the restructuring plan. For private joint-stock banks, this would be an opportunity to divest the shares of SOEs and to clean up the cross-ownerships among banks and with large private economic groups. Smaller and unviable banks could be submitted to an orderly bank resolution regime.

63. **This phase would include the implementation of critical improvements in financial infrastructure and financial regulation, and the preparation of more comprehensive regulatory and supervisory reforms to be implemented in the following phase.** The FSAP and the Detailed Assessments of Observance with International Standards and Codes provide numerous recommendations that could form the basis for a comprehensive reform of the regulatory and supervisory framework. The authorities should also consider programs to build supervisory capacity and IT infrastructure for all three supervisory agencies, with external technical support. Reforms of the tax treatment of loan-loss provisions and debt-write-offs, as well as measures to facilitate out of court enforcement of collateral, would provide the basis for more effective workout arrangements. The government and the SBV could also consider a revision of the debt workout strategy, and in this context, a revision of the legal structure and mandates of the new VAMC.

64. **Finally, the agenda for the development of capital markets and NBFIs could be initiated with the full launching of the Roadmap for Government Debt Development.** The capital market agenda is critical for Vietnam, as it can contribute to both access and stability objectives. During this phase, the government and the SBV could also start preparing key legislation for the introduction of fixed income instruments such as infrastructure bonds and covered bonds.

C. Third Phase: Consolidating the Reform Program

65. **The debt workout program would be fully launched in this phase.** The bank-led and VAMC components would be supported by the enactment of enabling legislation, and the VAMC would be properly staffed to perform its functions. By this time, the Government would also have the conditions to deepen the implementation of the special restructuring programs for large Economic Groups.

66. **In this phase, the Government and the SBV should implement measures to relieve the SOCBs from their policy mandates and ensure sound governance for both SOCBs and private banks.** The ownership and supervision functions should be conducted under separate institutional arrangements to ensure the effective exercise of ownership rights and the independence of supervision at the same time. SCOBs should operate with clear mandates, performance targets, and governance structures. Ideally, most policy functions and mandates would be transferred to the policy banks and these banks would also be financially and operationally restructured to play this role effectively. The development of corporate bonds and infrastructure bonds would also contribute to unburdening the SOCBs from policy functions and directed lending, and arguably enhance transparency. The changes to the Law on Credit Institutions and other supporting regulation would also address the key governance agenda, and the SBV would implement requirements ensuring clear separation of the roles of ownership, board oversight, and management; independent and professional boards; and stronger risk management functions.

67. **This phase will also include further deepening of the capital markets agenda and the full implementation of financial infrastructure and regulatory reforms.** This would include substantial progress in implementing the roadmap for the development of government bond markets and possibly introducing new private fixed income instruments, such as infrastructure bonds and covered bonds. Financial regulatory reforms should be accompanied by substantial progress in the implementation of the supervisory development programs.

Table 1: Selected Economic Indicators

Table 1. Selected Economic Indicators, 2006–13 1/

	2006	2007	2008	2009	2010	2011	Est. 2012	Projections 2013
Output								
Real GDP (percent change)	8.2	8.5	6.3	5.4	6.4	6.2	5.2	5.3
Saving and investment (in percent of GDP)								
Gross national saving	36.5	33.3	27.8	30.7	31.6	29.7	33.0	29.4
Gross investment	36.8	43.1	39.7	37.2	35.7	29.8	27.2	24.0
Prices (percent change)								
CPI (end of period)	6.7	12.6	19.9	6.5	11.7	18.1	6.8	8.2
General government finances (in percent of GDP) 2/								
Revenue and grants	28.7	28.7	29.0	25.0	27.2	25.2	22.9	22.2
Expenditure	29.1	31.2	30.2	31.6	30.0	28.1	27.7	26.2
Net lending (+)/borrowing(-) 3/	-0.4	-2.5	-1.2	-6.6	-2.8	-2.9	-4.8	-4.0
Public and publicly guaranteed debt (end of period)	42.9	44.6	42.9	46.9	51.7	47.9	51.3	50.4
Money and credit (percent change, end of period)								
Broad money (M2)	33.6	46.1	20.3	29.0	33.3	12.1	18.5	16.1
Credit to the economy	25.4	53.9	25.4	39.6	32.4	14.3	8.7	12.4
Interest rates (in percent, end of period)								
Nominal three-month deposit rate (households)	7.9	7.8	8.1	10.7	11.6	14.9	9.4	...
Nominal short-term lending rate (less than one year)	11.8	11.8	11.5	12.7	14.0	16.4	12.3	...
Balance of payments (in percent of GDP, unless otherwise indicated)								
Current account balance (including official transfers)	-0.3	-9.8	-11.9	-6.0	-3.8	0.2	5.8	5.6
Capital and financial account		15.4	14.0	11.2	4.1	4.1	4.4	2.5
Total external debt (end of period) 5/	31.5	32.4	33.4	41.6	44.3	37.9	39.0	39.1
Nominal exchange rate (dong/U.S. dollar, end of period)	16,068	16,017	17,483	18,479	19,498	21,034	20,825	...
Memorandum items:								
GDP (in trillions of dong at current market prices)	974	1,144	1,485	1,809	2,158	2,780	3,245	3,684
GDP (in billions of U.S. dollars)		71.1	90.3	101.6	112.8	134.6	155.6	170.0
Per capita GDP (in U.S. dollars)	724	835	1,048	1,182	1,298	1,532	1,753	1,896

Sources: Vietnamese authorities; and IMF staff estimates and projections.

1/ The national accounts have been rebased to 2010 from 1994 by the authorities. There is a break in the series from 2009 onwards.

2/ Follows the format of the *Government Finance Statistics Manual 2001* .

3/ Excludes net lending of the Vietnam Development Bank.

4/ Excludes government deposits.

5/ Uses interbank exchange rate.

Table 2: Structure of the Vietnamese Financial System

	Dec-07				Dec-11			
	Number of institutions	Total Assets [VND tln.]	Share of Total Assets %	Share of GDP %	Number of institutions	Total Assets [VND tln.]	Share of Total Assets %	Share of GDP %
Universal and Commercial Banks	78	1,733.3	80.5	151.5	97	4,750.5	85.9	170.9
Private	73	801.8	37.3	70.1	92	2,838.2	51.3	102.1
Domestic	*35*	*597.7*	*27.8*	*52.3*	*38*	*2,285.8*	*41.3*	*82.2*
Foreign	*38*	*204.0*	*9.5*	*17.8*	*54*	*552.4*	*10.0*	*19.9*
State-owned	5	931.5	43.3	81.4	5	1,912.3	34.6	68.8
Development Banks	2	189.7	8.8	16.6	2	346.4	6.3	12.5
Other depository institutions								
Cooperative banks	2	19.1	0.9	1.7	2	46.4	0.8	1.7
Other credit institutions								
Finance companies	8	69.0	3.2	6.0	18	159.5	2.9	5.7
Leasing companies	12	14.1	0.7	1.2	12	24.0	0.4	0.9
Investment banks and financial auxiliaries								
Securities brokers/dealers	62	54.9	2.6	4.8	102	81.0	1.5	2.9
Asset management companies	n.a.				n.a.			
Foreign exchange houses	n.a.				270			
Insurance								
Insurance companies	31	56.3	2.6	4.9	43	107.0	1.9	3.8
Life	*9*	*39.7*	*1.8*	*3.5*	*14*	*71.5*	*1.3*	*2.6*
Nonlife	*22*	*16.7*	*0.8*	*1.5*	*29*	*35.5*	*0.6*	*1.3*
Reinsurance companies	1	0.6	0.0	0.1	2	4.4	0.1	0.2
Pension funds 1/	n.a.				n.a.			
Collective investment schemes 1/								
Money market funds								
Investment Funds (closed)	17	15.4	0.7	1.3	23	10.3	0.2	0.4
Total financial system		**2,152.3**	**100.0**	**188.2**		**5,529.4**	**100.0**	**198.9**

Memorandum items:

	Dec-07 Total Value [VND TRlln.]	Dec-07 Share of GDP %	Dec-11 Total Value [VND TRlln.]	Dec-11 Share of GDP %
Capital Markets				
Outstanding Government bonds			353.6	12.7
Outstanding Bills	3.4	0.3	2.1	0.1
Outstanding Corporate bonds			35.5	1.3
Issued by Financial Firms (e.g. banks)			*21.6*	*0.8*
Issued by Non-Financial Firms			*10.8*	*0.4*
Equity Market Capitalisation	498.5	43.6	533.7	19.2
o/w financial sector	n.a.		n.a.	
Social Security Fund	68.7	6.0	181.0	6.5
GDP	1,143.7	100.0	2,779.9	100.0
Exchange Rate	16,017		21,034	

Sources: National authorities, IMF, ADB, Bloomberg

Notes:

1/ Assets under management

Table 3. Proposed Financial Reform Agenda

<table>
<tr><td></td><td></td><td colspan="2">FINANCIAL SECTOR REFORM</td></tr>
<tr><td></td><td>TEMPORARY FINANCIAL SAFEGUARDS</td><td>STOCK PROBLEM</td><td>FLOW PROBLEM</td></tr>
<tr><td>PRE-CONDITIONS</td><td>• Assess the extent of safeguards needed throughout the program</td><td colspan="2">• Special financial audits of all large banks, for estimation of NPLs and recapitalization needs, and inputs for the design of workout scheme;
• Special operational audits of State commercial and policy banks to guide restructuring program;
• Identification of SIFIs.
• Identification of interconnections among financial entities and development of contingency plans for addressing common vulnerabilities;
• Mapping of the NPL problem for the design of effective workout schemes.</td></tr>
<tr><td>SHORT-TERM MEASURES</td><td>• Temporary increase in deposit guarantees.</td><td>• Recapitalization of viable banks to regulatory minimums;
• Consider enhanced participation of foreign strategic investors in recapitalization;
• Orderly exit of small weak banks;
• Clean-up of cross-ownership positions;
• Finalize design of debt workout scheme;
• Finalize legal structure, mandates of AMC, staffing needs.
• Finalize draft legal reforms to support implementation of debt workout scheme</td><td>• Directive to banks requiring adoption of strict prudential rules on all new loans;
• Initiation of operational restructuring of State banks;
• Elaboration of supervisory development program for all three supervisory agencies;
• Implementation of critical improvements in financial infrastructure and financial regulation for short-term;
• Design of comprehensive financial infrastructure and regulatory reforms for next phase;
• Launch roadmap for government debt market development</td></tr>
<tr><td>MEDIUM-TERM MEASURES</td><td>• Replaced by revamped safety net.</td><td>• Full implementation of the debt workout scheme, supported by enabling legislation</td><td>• Introduction of package to reduce the policy burden of SOCBs
○ New roles emphasizing commercial orientation
○ Stronger governance structures, risk management
○ Shift of policy functions to policy banks
○ Enhanced participation of foreign minority shareholders
○ Development of infrastructure and corporate bonds
• Development of a properly functioning liquidity management framework.
• Deepening of capital market reforms
• Implementation of comprehensive financial infrastructure and regulatory reforms</td></tr>
</table>

Table 4: Key Technical Recommendations

Recommendations	Agency	Time-Frame
Banking regulation and supervision		
Strengthen the institutional setup for banking supervision by segregating and enhancing the prudential supervisory function, to be performed by the SBV and focused on safety and soundness, from the inspectorate function, to be performed by the General Inspectorate and State Audit Office and focused on violations of administrative rules.	BSA, SBV	Medium-term
Enhance the data collection, analysis, dissemination, and warehousing capabilities of the BSA.	BSA, SBV	Short-term
Develop proper monitoring of ultimate beneficiary ownership, as well as economic and banking groups by expanding the definition of related and interconnected parties.	SBV initiate	Medium-term
Enact new directives on bank governance, including stronger requirements for risk management; as well as strengthen the supervisory assessment capacity by developing overall and risk-specific risk management guidelines and internal guidance.	SBV	Short-term
Strengthen the assessment and monitoring of banks' asset classification and provisioning practices (including valuation of collateral) by developing internal guidance and enhancing capacity of supervisory staff.	SBV	Short-term
Stress testing		
Revise the definition of liquid assets and short-term liabilities to exclude assets that cannot be sold immediately.	BSA	Medium-term
Review the mandatory prudential haircuts and roll-over ratios in the calculation of liquid assets and short-term liabilities.	BSA, SBV	Medium-term
Insurance		
Develop supervisory/regulatory development plan to set priorities and implement operational challenges.	MOF/ISA	Short-term
Move to modern supervisory models along with enriched human resources and strengthened infrastructure.	MOF/ISA	Medium-term
Develop and establish standards on insurance corporate governance and internal controls.	MOF/ISA	Medium-term
Restructure MTPL insurance and move to risk-based pricing.	MOF/ISA	Medium-term
Securities		
Strengthen oversight of market intermediaries and customer assets and accelerate the ongoing resolution process of securities firms.	SSC	Short-term
Pursue plans for a customer compensation fund.	SSC	Medium-term
Strengthen securities markets surveillance and related price reporting regimes.	SSC	Medium-term
Enhance settlement infrastructure and related law.	SSC	Long-term
Macroprudential issues		
Define in the legal framework a "financial stability" mandate; the agencies in	SBV/MOF	Medium-

Recommendations	**Agency**	**Time-Frame**
charge of ensuring it; and start exercising the function.		term
Develop consolidated supervisory framework and enhance inter-agency coordination.	SBV, BSA, MOF, ISA, SSC, DIV	Medium-term
Rely less on administrative and more on market-based measures for regulating the financial system.	SBV, MOF	Medium-term
Crisis management and bank resolution framework		
Implement multi-track restructuring approach with components led respectively by banks, courts, AMC, and high-level administrative processes.	SBV/MOF	Short-term
Adopt and implement legislative reform to bankruptcy, enforcement, enterprise, land, and tax laws.	Supreme People's Court, MOJ, SBV, MOL, MOF	Short-term
Apply existing crisis management tools more aggressively.	SBV, BSA	Short-term
Develop an option under law to undertake a purchase and assumption transaction.	SBV, BSA	Short-term
Financial market infrastructure		
Develop a new law that would treat all the aspects related to payment and securities settlement systems in a holistic manner.	SBV	Short-term
Develop a comprehensive risk management framework for the IBPS, SBV CSD and the linkages of these FMIs with the other FMIs in Vietnam (credit, liquidity, custody and investment, operational risks).	SBV	Short-term
Develop oversight policy objectives and strengthen the oversight implementation capacity to effectively implement the PFMIs.	SBV, SSC	Short-term

Figure 1: Benchmarking the Vietnamese Financial Sector

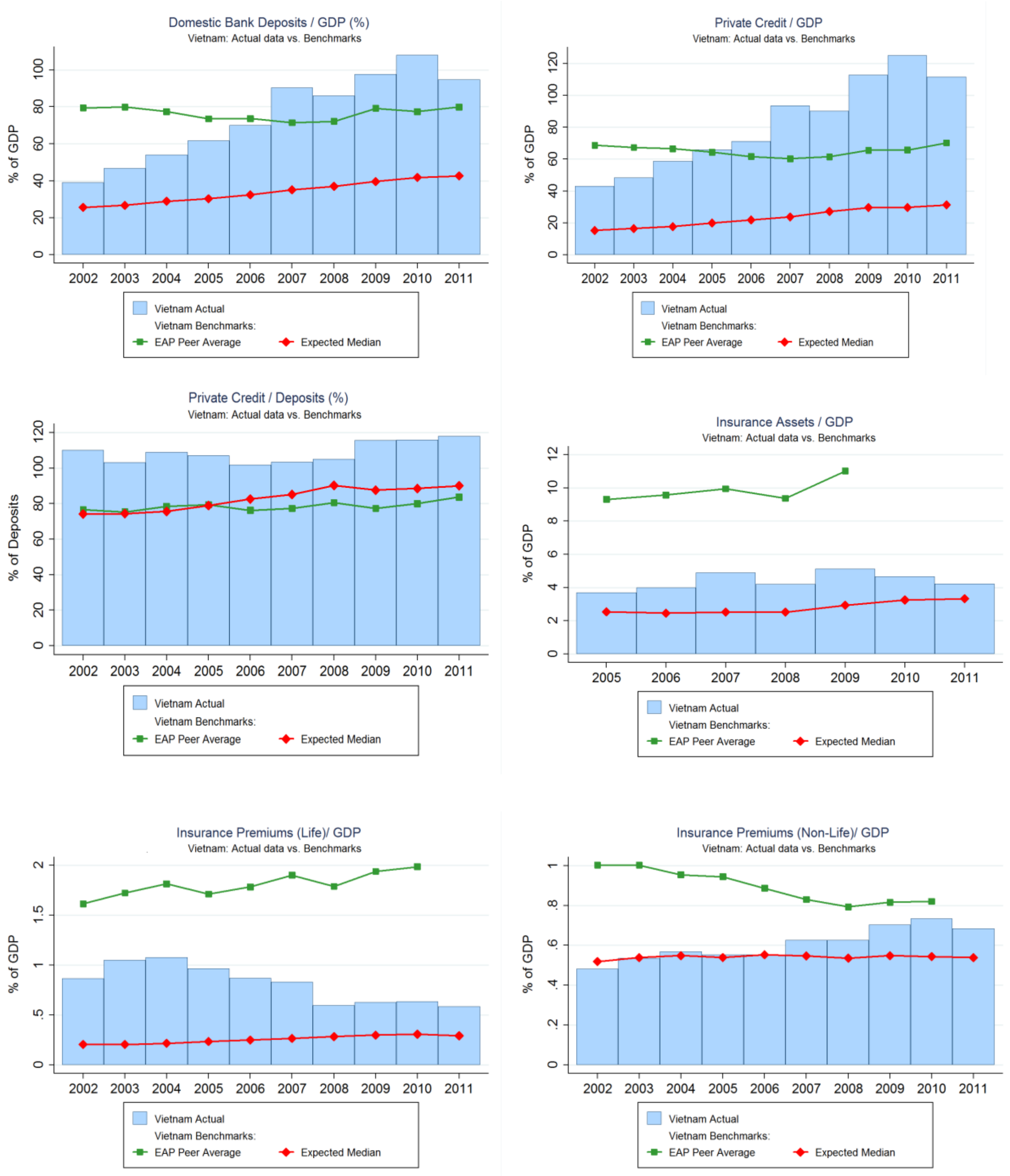
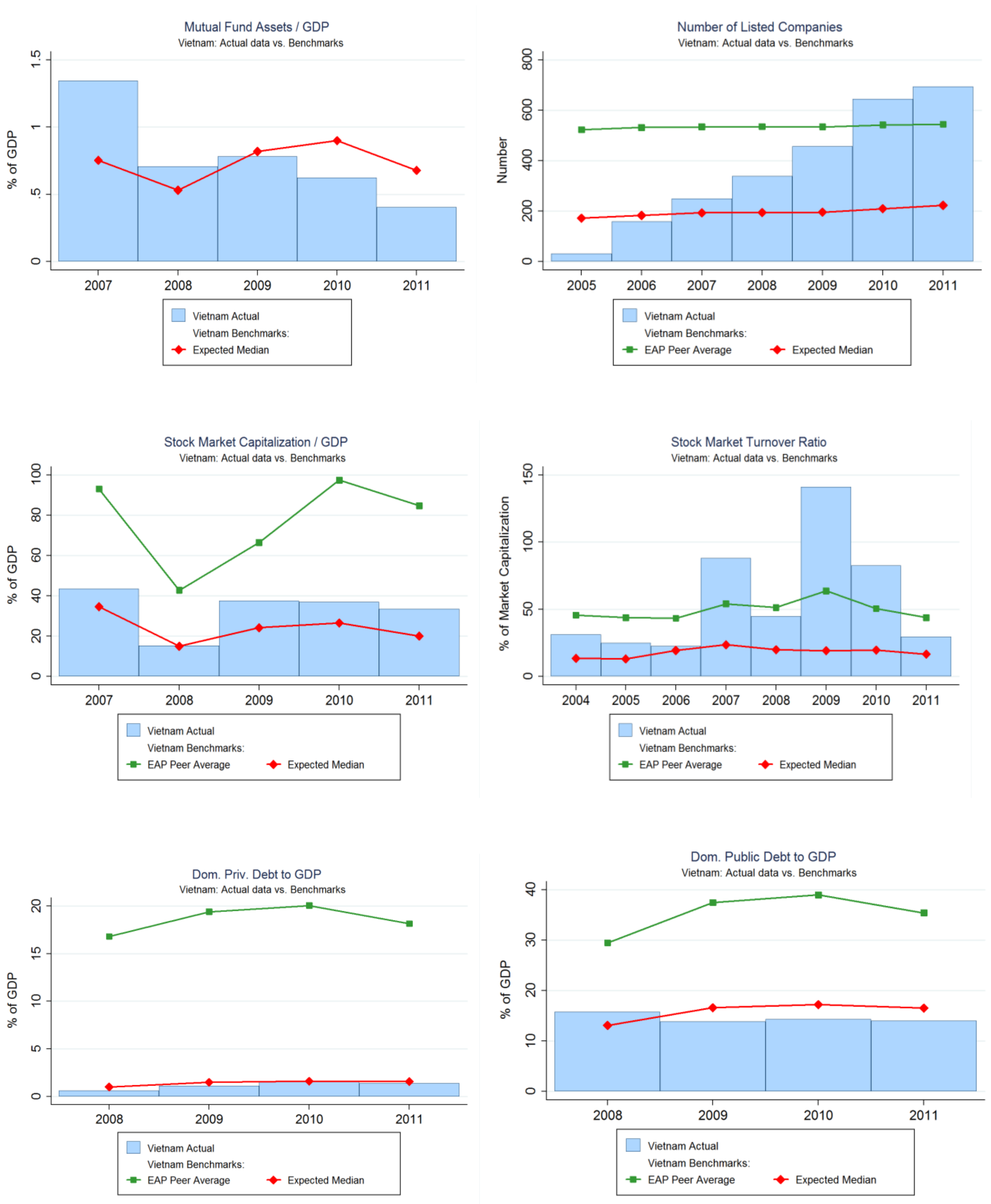


Figure 1. Structure of the Vietnamese Financial Sector (continued)



EAP Peer average: Malaysia, Thailand, Indonesia, Philippines
Source: Authorities, World Bank Finstats, IMF, ADB, Bloomberg

Benchmarking done based on Beck, T., E. Feyen, A. Ize, and F. Moizeszowicz (2011). "Benchmarking Financial Development", World Bank and using the FinStats database: http://FinStats