Project Information Document/ Identification/Concept Stage (PID)

Concept Stage | Date Prepared/Updated: 25-Jun-2019 | Report No: PIDC194870

BASIC INFORMATION

A. Basic Project Data

Project ID	Parent Project ID (if any)	Environmental and Social Risk Classification	Project Name
P171375		Low	Vietnam: Strengthening Banking Sector Soundness and Development
Region	**Country**	**Date PID Prepared**	**Estimated Date of Approval**
EAST ASIA AND PACIFIC	Vietnam	25-Jun-2019	
Financing Instrument	**Borrower(s)**	**Implementing Agency**	
Investment Project Financing	The State Bank of Vietnam	Ministry of Finance	

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Project Cost	2.27
Total Financing	2.27
Financing Gap	0.00

DETAILS

Non-World Bank Group Financing	
Trust Funds	2.27
Vietnam - Free-standing Trust Fund Program	2.27

B. Introduction and Context

Country Context

Vietnam's GDP per capita growth has been among the highest in the world, averaging 6.4 percent a year since 2000. High economic growth together with socially oriented policies have enabled Vietnam to achieve remarkable progress in poverty reduction and shared prosperity. Despite growing uncertainties in the global environment Vietnam's economy remains resilient. The country's medium-term outlook remains favorable with GDP expanding by 7 percent in 2018 and medium-term projections of 6.5 percent while the country's fundamental drivers of growth – resilient domestic demand and export-oriented manufacturing – remain strong. Economic and political reforms under Đổi Mới, launched in 1986 spurred rapid economic growth and development and transformed Vietnam from one of the world's poorest nations to a lower middle-income country.

In line with its strong economic performance Vietnam has experienced rising levels of formal financial intermediation and deepening. Banking system assets today are almost 2 times GDP. In 2001, there were barely 200,000 private bank accounts in the entire country, credit/debit cards and ATM machines were almost non-existent. By the end of 2018, there were 86 million active ATM/debit and credit cards, 304,486 points of sale (POSs) and 18,434 ATMs.[1] By July 2018, there were 72.7 million private bank accounts, i.e. 43.2 million people had a bank account representing 60 percent of the population 15 years of age and above.[2]

[1] Vietnam Bank Card Association.

[2] SBV

Sectoral and Institutional Context

The banking sector is the largest segment of the Vietnamese financial system. It is large by international comparison, whether measured by deposits or credits. Credit growth has been increasing since 2015 and was approximately 14 percent in 2018. The ratio of total loans to GDP has been steadily rising, registering 194% in end 2017. Much of the rapid credit growth in recent years has occurred through the banking system. Bank deposits have been high in comparison with other middle-income countries, reflecting a large savings ratio, rapid economic growth, and slower development of other conventional savings products. The ratio of credit to GDP is driven by very high investment ratios and exceeded the relevant benchmarks by significant margins in the same period. The ROE of Vietnamese banks was around 14.3 percent on average in 2018, which compared favorably with other emerging markets at similar levels of development. Despite this, the Vietnamese banks are facing with higher overheads and provisioning costs due to the high levels of accumulated NPLs. More recently, profitability and ROE's have been improving due to expanding lending in different market segments due to the growing middle-income class and diversifying towards fee-based income.

The share of State-Owned Commercial Banks (SOCBs) in the banking system has declined steadily, although they still account for nearly half of the outstanding loans in the economy. The securities market has also developed, with nearly 1,500 companies listed (365 on Ho Chi Minh Stock Exchange, 376 on Hanoi Stock Exchange and 772 on Upcom market) and market capitalization of over 102 percent of GDP by the end of August 2018.

The 2013 WB-IMF FSAP, that followed the turbulent period of 2011/12 recommended that the regulatory and supervisory framework of the SBV needed to be strengthened. Important gaps in the legal and regulatory framework that included inadequate enforcement and weak crisis management were also identified in the FSAP. The Government subsequently issued Decision 254 in early 2012 approving a scheme to restructure the credit institutions between 2013 and 2015. Encouraging progress was made regarding the targets set forth in the Decision, most notably addressing the lack of system liquidity, introducing strengthened supervision and regulation, sector consolidation and to some extent, NPL resolution. At the same time, stricter regulations on loan classification and provisioning as well as prudential ratios that are more aligned to internationally agreed standards and good practice were promulgated. More than a dozen ailing banks were effectively brought under control, either through mergers or by direct control by the SBV[1], so that the systemic risks these institutions pose are being managed for now.

In terms of bad debt resolution, a major step in handling the NPLs in the banking system was the establishment of the Vietnam Asset Management Company (VAMC) in July 2013. VAMC acquired approximately VND310,000 billion (equivalent to around $13.5 billion) in NPLs by the end of 2017, financed by the issuance of VAMC (special) bonds. The transfer of these bad debts to VAMC played a key role in reducing the NPL ratio on the banks' balance sheets along with the renewed credit expansion starting in 2015, although this approach did not lead to a full and transparent NPL loss allocation or to an effective reduction of NPLs in the system. There have been several initiatives to support VAMC in resolving its NPLs faster, such as the regulation on fair-market-value mechanism for NPL purchases by VAMC (i.e. VAMC issues bonds and purchases NPLs with the proceeds of bond raisings and its own cash), allowing VAMC to be more flexible in the disposal of NPLs. However, in practice and until recently, not much has been resolved using this mechanism. In terms of being more active in the resolution of NPLs, the VAMC's capacity in this regard is limited by its capital base. The Government plans to increase the VAMC capital in two tranches to VND5,000 billion in the first tranche and VND10,000 billion in the second tranche.

There have also been recent improvements in the legal and regulatory framework over the past decade. The two banking laws (i.e. State Bank of Vietnam Law and Credit Institutions Law) were revised and took effect as of January 2011, and a series of guiding regulations have laid the foundation for the strengthening of the SBV's role and for the development of more agile credit institutions. Resolution 42 was introduced in May 2017 to allow for the authorities to address the NPLs problem in Vietnam in a more systematic and effective manner. More recently the Credit Institutions Law was revised in November 2017 to allow the SBV to address the weak credit institutions.

Generally, reforms have strengthened bank balance sheets. Bank profits and asset quality are improving in most large banks which is supported by the strong economy and faster disposal of NPLs. Resolution 42 and higher real estate prices are facilitating the disposal of collateral and the restructuring of bad assets in the banks as well as the VAMC. Amendments to the Law on Credit Institutions are enhancing bank corporate governance by clarifying bankruptcy and other restructuring options. Overall, the banking system has become more competitive.

While Vietnam was able to avoid a full-blown banking crisis in late 2011-early 2012, structural and systemic risks remain. Important weaknesses also remain in the form of thin capital buffers in some banks and emerging financial risks. Profitability was low relative to other ASEAN countries, but has improved substantially in recent years but their ability to use profits to boost capital is hampered by required dividend payments. Moreover, the capital base of some SOCBs and a few private banks remains low. These factors may amplify potential risks to financial stability given the sizable credit gap, thin capital buffers, and regulatory limits to private sector ownership.

The recent shift to consumer lending, including mortgages and durable goods, and margin lending, although good for diversifying the loan books of banks presents new macro-prudential challenges. Strong growth in asset prices, driven by improved fundamentals, capital inflows, and accommodative credit conditions may lead to a buildup in financial sector risks, necessitating a strong macro-prudential regulation and supervision framework. The framework will need to be strengthened by introducing leverage ratios and countercyclical capital buffers, complemented by policy tools for retail and mortgage loans, such as loan-to-value, debt service-to-income requirements and risk weight differentiation. It should ensure that sufficiently robust liquidity and crisis management frameworks—including legal and operational clarity on early intervention, information sharing, and communication—are in place to weather shocks.

While the SBV has taken steps to contain the imminent risks of banking sector instability, deeper structural reforms are required. This strategy involves a shift toward a market-oriented banking sector underpinned by international standards, with a priority to stabilization rather than growth, and a full consideration for financial stability monitoring and macroprudential supervision. The strategy also aims to converge toward international standards and good practices. From a macroeconomic and macroprudential point of view, this new paradigm should support the economic growth of the country as sustainably as possible. Several necessary reforms are highlighted in the new Development Strategy of Vietnam Banking Sector Strategy till 2025. Overall, the strategy signals a strong commitment of the authorities to address the structural deficiencies and key risks facing the banking sector in Vietnam. The immediate priority should be to address the remaining vulnerabilities and weaknesses in the banking sector.

[1] Statutory managers were appointed by the SBV for three banks.

Relationship to CPF

As noted in the CPF for fiscal years 2018-2022, under focus area 1: “Enable Inclusive Growth and Private Sector Participation”, financial stability is among the priorities for objective 1: “Strengthen Economic Governance and Market Institutions”. Accordingly, in the Government’s SEDP 2016-2020, reform of the financial sector is also emphasized. Traditionally, it has been recognized that Vietnam’s vulnerability to macroeconomic instability has structural roots in distortions in the SOE and financial sector”. The 2013 WB-IMF Financial Sector Assessment Program also provided a comprehensive diagnostic of the weaknesses in the financial sector and proposed a comprehensive program of reforms including bank restructuring and capitalization (by the State and new private investors), a well-articulated NPL resolution program, and comprehensive reforms designed to strengthen financial infrastructure and the regulatory and supervisory framework. The authorities, notably the SBV, have developed post-FSAP assistance programs (e.g. the detailed post-FSAP action plan approved by the Governor in July 2014 regarding activities/regulations in the areas of financial stability, banking supervision, financial infrastructure and NPL resolution/VAMC) to further enhance the safety and soundness of individual banks and the resilience of the financial system and improve financial intermediation to the real economy.

C. Project Development Objective(s)

Proposed Development Objective(s)

The development objective of the Trust Fund is to enhance the capacity of the SBV to address structural weaknesses in the banking system.

Key Results

Specifically, the project seeks to achieve: (i) A legal framework better aligned with international standards and good practice including evolving standards for banking resolution; (ii) A more robust regulatory and supervisory framework, reflected in improved compliance with several Basel Core Principles (BCPs), that will help ensure the safety and soundness of the banking system; (iii) A more efficient and effective VAMC equipped with actual tools/mechanisms to resolve NPLs of commercial banks; and (iv) Strengthened SBV's macroprudential management capacity to better anticipate and manage potential risks emanating from the banking sector, thereby enhancing overall financial sector stability.

D. Preliminary Description

Activities/Components

The proposed program aims to address Vietnam's challenges in an integrated and comprehensive manner. It consists of the following pillars and key results:

1. **A legal and regulatory pillar, designed to provide the authorities with a legal framework better aligned with international standards and good practice for banking supervision and the emerging new standards for banking resolution to address the challenges for individual banks and the banking system that will likely emerge in the second phase of the banking restructuring plan;**
2. **A banking supervision and regulation pillar, aimed at strengthening the effectiveness of regulatory and supervisory frameworks and practices, by ensuring forward looking, preventative supervision resulting in safe and sound banking institutions;**
3. **A pillar on NPL management, aimed at strengthening VAMC's governance and formulating the mechanisms, tools and instruments to efficiently resolve accumulated stocks of NPLs and address credit institutions that have been weakened by high NPLs;**
4. **A pillar on macroprudential supervision of the banking system as a whole, that would strengthen the ability of the SBV to enhance the capacity and instruments of macroprudential supervision and reduce the spillover risk from the financial sector to the rest of the economy.**

These four pillars are mutually reinforcing in building a cohesive package to strengthen the resilience of the banking system. The guiding principles behind the proposal aim to (i) align as much as possible with the authorities' stability agenda for the financial sector, with particular attention to banking sector soundness; (ii) complement the efforts that other donors and agencies (e.g. BRASS, JICA, IMF and SECO)[1] are undertaking and avoid duplication of efforts; and (iii) focus on those areas where the WB has deep knowledge and substantive cross-country experience.

[1] The BRASS project funded by the Government of Canada supports the SBV in developing a Risk Based Supervision (RBS) Framework and capacity building to implement Basel II. JICA has provided advisory activities on NPLs resolution, drawing heavily from the Japan experience. SECO is also funding technical assistance for the SBV on a bilateral basis to train bankers in modern management skills. With the World Bank Group, SECO has provided support for technical assistance for Public Financial management supporting the World Bank Governance team and also supports IFC advisory activities related to credit infrastructure, payments, insolvency regimes, debt resolution and microfinance. SECO is also funding TA for capital markets development in Vietnam. The IMF currently does not have any TA activities with the SBV, although they have received several requests to provide support for the Monetary Policy Dept.

Environmental and Social Standards Relevance

E. Relevant Standards

ESS Standards		Relevance
ESS 1	Assessment and Management of Environmental and Social Risks and Impacts	Relevant
ESS 10	Stakeholder Engagement and Information Disclosure	Relevant
ESS 2	Labor and Working Conditions	Relevant
ESS 3	Resource Efficiency and Pollution Prevention and Management	Not Currently Relevant
ESS 4	Community Health and Safety	Not Currently Relevant
ESS 5	Land Acquisition, Restrictions on Land Use and Involuntary Resettlement	Not Currently Relevant
ESS 6	Biodiversity Conservation and Sustainable Management of Living Natural Resources	Not Currently Relevant
ESS 7	Indigenous Peoples/Sub-Saharan African Historically Underserved Traditional Local Communities	Not Currently Relevant
ESS 8	Cultural Heritage	Not Currently Relevant
ESS 9	Financial Intermediaries	Not Currently Relevant

Legal Operational Policies

Safeguard Policies	Triggered	Explanation (Optional)
Projects on International Waterways OP 7.50	No	The project will neither finance nor support any civil works activities or detailed design and engineering studies that fall within the scope of application of OP 7.50.
Projects in Disputed Areas OP 7.60	No	The project will not be implemented in any disputed areas.

Summary of Screening of Environmental and Social Risks and Impacts

As part of environmental and social (E&S) screening, the team has reviewed the project concept note, experience of relevant projects, related laws and regulations including Law on Environmental Projection, Land Law, Labor code. The aim of the project is to enhance the capacity of the SBV to implement measures better aligned with international standards to address structural weaknesses in the banking system. Therefore, it does not involve the development of any physical infrastructure or associated activities like construction/rehabilitation works and civil works. The environment and social screening did not identify any potential environmental and social risks and/or impacts based on the initial information collected from scope of activities described in the Project's Concept Note, or the experience of SBV in implementing WB financed activities. Therefore, the environmental and social risk for the Project is low under the World Bank ESF because of the negligible or minimal environmental and social risks associated with the project. Therefore, the E&S risk of the project is classified as low. The SBV will incorporate E&S risk management procedures consistent with ESS1 consistent with ESS1 in the Grant Operational Manual. These will primarily focus on labor and working conditions (ESS2) and stakeholder engagement (ESS10). ESS3, ESS4, ESS5, ESS6, ESS7, and ESS8 are not considered relevant as the grant will finance consulting and advisory services that are primarily focused on SBV and the banking sector in Vietnam. ESS9 on Financial Intermediaries is also not considered relevant, as the grant will not provide funds to be on-lent to any FI. Given the project negligible adverse risks and impacts and issues, no further ES assessment following the initial screening is required. Prior to Bank Board Approval of the project, the Borrower will prepare a Stakeholder Engagement Plan to be included in Grant Operational Manual. The elements of the SEP will be reflected in the ESCP.

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