

# VIETNAM

## BANKING

### *SUMMARY*

Vietnam is attempting to develop the basic infrastructure to support a modern banking system and financial markets. Over the past two years the government has initiated projects to modernize the interbank payments system, adopt international accounting standards, and allow independent audits of major Vietnamese banks. However, the use of banking services by the general public remains limited, and most retail transactions are in cash.

The banking sector is regulated by the State Bank of Vietnam, a ministerial-level agency. Although a number of small joint-stock banks have been formed, four state-owned banks still dominate domestic banking activity. Three U.S. banks have established branches or representative offices in Vietnam, and one U.S. bank has pending an application to open a branch.

In 1997, foreign-bank branches and joint-venture banks accounted for almost 20 percent of the Vietnamese market's total mobilized capital, and their share of lending in Hanoi and Ho Chi Minh City increased from 14 percent in 1994 to about 50 percent in 1997. However, foreign banks remain restricted in their ability to provide a full range of services and to expand operations in local currency.

### *DESCRIPTION OF THE MARKET*

#### **Market Structure**

As of mid-1998, approximately 82 banks were operating branches and representative offices in Vietnam, including 4 state-owned banks, 4 joint-venture banks, 52 joint-stock banks, 24 foreign-bank branches, and 68 foreign-bank representative offices. In addition, there are many microfinance organizations, including People's Credit Funds, the Bank for the Poor, and savings and credit groups under the Women's Union.

The four state-owned banks – the Vietnam Bank of Foreign Trade (Vietcombank), the Vietnam Industrial and Commercial Bank (Incombank), the Bank for Agriculture and Rural Development, and the Vietnam Investment Bank – still dominate domestic banking activity, providing an estimated 70-80 percent of all lending. Formed with the four state-owned banks, the joint-venture banks are the VID Public Bank (Malaysia), Indovina Bank (Indonesia), Firstvina Bank (South Korea), and Vinasiam (Thailand).

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The first foreign bank in Vietnam, the Banque Française du Commerce Extérieur (BFCE), opened a representative office in 1989. Several other European and Asian banks followed rapidly. In 1992, foreign banks were allowed to open full commercial branches with required local operating capital of US\$15 million. Foreign banks now provide a variety of traditional services, such as correspondent banking, cash management, international payments, and foreign exchange services. In 1997, according to information from the State Bank, foreign-bank branches and joint-venture banks accounted for almost 20 percent of the Vietnamese market's total mobilized capital, and their share of lending in Hanoi and Ho Chi Minh City increased from 14 percent in 1994 to about 50 percent in 1997.

Despite the growing number of banks, over 50 percent of local business transactions are conducted outside the banking system. (The figure would probably be higher if commodity exports and government transactions were excluded.) Furthermore, many cash transactions in Vietnam take place in dollars. The financial intermediation of domestic savings has been made difficult by managed interest rates, which do not reflect market rates. Other problems include lingering distrust of the domestic currency (due to hyper-inflation and scandals) and the lack of basic infrastructure to support a modern banking system. These problems have resulted in very little medium-term and long-term capital being made available for private-sector businesses. For example, paper checks are still not widely used, in part because they expire within fifteen days of issuance. However, the Vietnamese government is in the process of creating a national payments, clearing and settlement system.

Vietnam's banking system also suffers from a lack of consumer confidence. The Vietnamese public keeps an estimated 45-50 percent of the broad money supply in cash and gold. Less than 5 percent of the general population has a bank account. However, Automated Teller Machines (ATMs) are now available in Hanoi and Ho Chi Minh City. Electronic banking is still limited but is becoming more widespread.

### **Regulatory Structure**

The State Bank of Vietnam is both Vietnam's central bank and its financial regulatory agency. It supervises all of the state-owned, joint-venture, joint-stock, and foreign banks operating in the country. The State Bank has offices with bank examiners in 53 provinces and its Banking Supervision Department employs about 500 staff nationwide. The newly-appointed Governor serves concurrently as Deputy Prime Minister with responsibility for economic issues. The First Deputy Governor manages day-to-day operations of the State Bank.

The success of economic reforms in stimulating growth over the past ten years has placed new demands on Vietnam's financial sector, which formerly operated largely in isolation from international standards and practices. A depressed real estate market, combined with a number of improperly-issued loans in 1996-97, has led to widespread recognition of the need for re-evaluating

the regulatory policies and management practices that govern Vietnamese banking. The World Bank and the Asian Development Bank, among others, are providing training and other assistance to modernize the banking system.

### ***U.S. PRESENCE IN THE MARKET***

Following the lifting of the U.S. trade embargo in 1994, three U.S. banks opened offices in Vietnam. At present, four U.S. banks and financial institutions operate in Vietnam, two with branches (Bank of America, Citibank) and three with representative offices (American Express, Chase Manhattan, and Bank of America).

In October 1997, after a wait of three years following its application, Citibank received permission to open a branch in Ho Chi Minh City. (It already had a branch in Hanoi.) The new branch opened in January 1998. Bank of America also operates two branches in Vietnam. Chase, which has a representative office in Hanoi, applied to open a Ho Chi Minh City branch in October 1997. (It has yet to receive approval.)

Several Vietnamese state-owned and joint-stock banks have active correspondent relationships with U.S. banks. The most significant part of U.S. bank operations is project and trade finance, primarily for foreign corporate clients.

### ***TREATMENT OF U.S. FINANCIAL INSTITUTIONS***

The financial services sector is similar to other service sectors in Vietnam in that the ability to establish an entity is not subject to consistent and transparent criteria. Generally, a quota is imposed on the number of licenses that may be issued in a particular period. Even if a foreign firm is permitted to establish an entity, that entity is subject to additional restrictions beyond those that apply to Vietnamese enterprises. In the banking sector, the following specific issues are of concern to foreign banks.

The “Ordinance on Banks, Credit Cooperatives, and Financial Companies” (the Ordinance) provides that foreign financial institutions may be established upon application to and if permitted by the State Bank. The Ordinance specifies the contents of the application form, which provides background information about the applicant to the State Bank. It does not contain any detailed criteria that a foreign financial institution must satisfy in order to be permitted to establish operations in Vietnam.

U.S. and other foreign banks seeking to enter the banking sector can do so through a joint venture with a Vietnamese bank or through the establishment of a branch or representative office. Foreign

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branches and representative offices are subject to differences in treatment or scope of permissible activities as compared to joint-venture banks.

Under present law, the treatment of a foreign branch versus a foreign subsidiary is not significantly different. The current advantage of a branch structure is that its regulatory capital is based on the parent organization's capital (however, the parent is responsible for branch losses). The regulatory capital of a foreign subsidiary is limited to its own capital.

The current policy of the State Bank is to limit the number of foreign financial institutions that may establish branches in Vietnam. For at least the last 18 months, there has been a *de facto* moratorium on the issuance of new bank licenses. Therefore, regardless of the corporate structure of U.S. financial institutions, it has not been possible for another U.S. bank to establish a branch in Vietnam.

According to State Bank officials, approvals of additional foreign bank operations are on hold due to a pending overhaul of the Vietnamese banking system. The State Bank also indicated in January 1998 that it would not issue new branch or representative office licenses for foreign banks during 1998 and that it would suspend the issuance of licenses for foreign joint-venture banks for 2-3 years. These officials expressed concerns that Vietnamese banks might not be able to compete successfully with U.S. and other foreign banks and, therefore, they have limited the range of services open to foreign banks.

Aside from the moratorium mentioned above, Vietnam has no explicit restriction on the number of branches of foreign banks. Each branch must be individually approved by the State Bank and, to date, no foreign bank has been permitted to open more than two branches. All foreign banks have chosen to locate in Hanoi and/or Ho Chi Minh City, the two largest cities in Vietnam.

As mentioned above, foreign banks are regulated under the "Ordinance on Banks, Credit Cooperatives and Financial Companies" (the Ordinance) dated May 23, 1990. They are also regulated under "Decree No. 189/HDBT" (the Decree) dated June 15, 1991. These documents provide procedures for establishing foreign-bank operations and list the types of services a foreign-bank branch or joint-venture bank may offer.

Articles 6 through 12 of the Decree set forth conditions and procedures for obtaining a banking license and opening a bank. Articles 13 and 14 of the Decree describe the operations a foreign-bank branch or joint-venture bank may perform.

According to Article 13 of the Decree and the terms of its banking license issued by the State Bank of Vietnam, a foreign-bank branch or joint-venture bank may perform some or all of the following foreign currency operations: foreign currency deposits, foreign currency lending, foreign currency investment, purchase and sale of bonds in foreign currency, import and export finance, issuance of

foreign currency guarantees, conversion of foreign currency, purchase and sale of foreign currency for its own or its clients' accounts, and "other operations that the State Bank may authorize."

Under Article 14 of the Decree and again according to the terms of its license, a foreign-bank branch or joint-venture bank may carry out some or all of the following operations in Vietnamese currency: short, medium, and long-term deposits; short, medium, and long-term loans; bond dealing; payment operations; and "other operations that the State Bank may authorize." The State Bank may limit a foreign or joint-venture bank's Vietnamese currency resources.

While the licenses granted to foreign-bank branches permit these branches to conduct transactions in foreign currency and in Vietnamese dong, apparently the state-owned banks have an informal policy of refusing to lend dong to foreign-bank branches. Interest rates for borrowing dong on the interbank market approach the ceiling rate at which banks are allowed to lend. In effect, this condition makes it impossible for foreign banks to lend Vietnamese dong profitably. Furthermore, foreign banks are restricted in their ability to take deposits from non-borrowing customers, and they may not offer savings accounts.

Foreign-bank branches are prohibited from accepting U.S. dollar deposits in cash from organizations. Therefore, although a large amount of cash is floating through the underground economy in Vietnam, no mechanism allows this cash to be deposited in foreign-bank branches.

Vietnamese enterprises, including state-owned enterprises and foreign enterprises, are prohibited from opening more than one foreign-exchange bank account. The state-owned banks have emphasized to state-owned enterprises the importance of such enterprises maintaining their links with the state-owned banks. In effect, this policy obliges state-owned enterprises to close their accounts with foreign-bank branches and restricts them from opening new accounts with foreign banks.

Different regulations and limits apply to foreign-bank branches and domestic credit institutions regarding long and short positions in foreign currencies. The allowed percentages of capital differ for foreign-bank branches and all other domestic credit institutions, with foreign-bank branches subject to a 15 percent limit and all other domestic credit institutions subject to a 30 percent limit. In addition, the calculation of regulatory capital is not transparent for the state-owned banks and, therefore, these regulations are enforced only against foreign-bank branches and joint-stock banks.

Unlike domestic banks, foreign banks are not permitted to take security interests in land or land-use rights. This prohibition effectively eliminates mortgage-based financing, and severely undermines asset securitization and project financing, by foreign banks. Moreover, the ability of foreign-bank branches to take security interests in other property, including accounts receivable and inventory, is unclear and inconsistent under ambiguous regulations (particularly if that property is owned by state-owned enterprises).

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In an attempt to regulate the banking industry more comprehensively, the National Assembly last year passed two new laws. One law governs banks and credit institutions and the other law outlines the responsibilities of the State Bank. Both new laws took effect on October 1, 1998.

The new “Law on Credit Institutions” defines the forms of foreign involvement in Vietnam’s banking sector and the conditions and procedures for license applications. Both are little changed from existing law and regulation. The new law emphasizes the dominant position of the state sector, suggesting that state-owned enterprises and state-owned credit institutions will continue to be protected and favored. However, the new laws do not specify restrictions on foreign bank activities.

The ultimate effects of the new law on foreign banks in Vietnam will depend on implementing regulations now being prepared. For example, regulatory authorities apparently considered basing the legal lending limit of a foreign-bank branch on the capital of the branch rather than the capital of the parent, as the policy has been in the past (although there are conflicting views on this issue). The lending limit is scheduled to increase from 10 percent to 15 percent under the new law. Because most foreign-bank branches have no more than US\$20-30 million in capital, this provision would have limited the maximum loan to a single customer to US\$3-4.5 million in October 1998. Lending capped at this level may not be efficient and may not permit foreign-bank branches to adequately service their clients. However, the State Bank recently announced that capital will be based on the parent bank. State Bank officials have stated that Vietnam eventually will have uniform regulations for both foreign and domestic banks.

The new Decree 63, Decision 173, and Circular 08, which relate to the de-dollarizing of the Vietnamese economy, require the conversion of 80 percent of non-exempt dollars to dong within 15 days. Foreign banks must bear the onerous and costly expense of policing the conversion. In addition, while the economy is being de-dollarized, foreign banks still have difficulty funding themselves in dong in order to make local currency loans.