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**TRENDS AND DEVELOPMENTS IN INSOLVENCY SYSTEMS AND RISK
MANAGEMENT - THE EXPERIENCE OF VIETNAM**

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Introduction and Summary

Vietnam's development continued to show a positive trend in 2003 and in the ten months of 2004. Vietnam's GDP growth remains the second highest rate in South-East Asia after China. Commercial banks' credit was also posted a high growth rate in the recent years. However problem with non performing loans and distressed assets - largely relating to the State Owned Enterprises-remains unresolved. The burden of NPLs and NPA has been a big problem causing the slow down of the reform process of Vietnam and hampered the economy. The NPLs and NPAs resolution is placed high in the government reform agenda as have been reported as a big problem for transforming (i.e equitise, sell, rent) the State Owned Enterprises.

Rooted from the centrally planned economy, insolvency and non performing loans are mainly involved State Owned Enterprises and State owned Bank. In addition to AMC of commercial banks, the government has established and put into operation a new special vehicles, Debts and Assets Trading Company – a national AMC that managed by the Ministry of Finance. Policy are issued for banks and DATC to resolve the NPLs but the achievements today are largely attributed to sell the foreclosed assets

Risk management practice at commercial banks in Vietnam is in process to improve. All the five state owned banks (account for about 80% capital and, lending and total assets of the whole banking system) were required by the State Bank of Vietnam to design and implement a new credit manual.

A. TRENDS AND DEVELOPMENTS IN INSOLVENCY AND CREDITOR RIGHTS FRAMEWORKS AND PRACTICES

I. Current legal and institutional developments

There is no comprehensive law dealing with corporate insolvency in Vietnam. Insolvency and creditor rights are regulated in many regulations including Law on Bankruptcy, Civil law, Ordinance on Economic Contract etc. However, these regulations are sometime unclear, inconsistent and might lead to different interpretation and application. More importantly, the lack of enforceability leading to the fact that the creditor rights were not always respected and long delay in resolving debts was seen. Under the old Law on Bankruptcy, very few bankruptcy cases were realised. Vietnamese National Assembly has passed a new Law on Bankruptcy on 15 June 2004 that come into force on 15 October 2004.

More regulations are issued including those pertaining:

- Equitisation of State Owned Enterprises
- Selling State Owned Enterprises
- NPLs resolutions for commercial banks and State Owned Enterprises
- Recapitalisation of the State Owned Commercial Banks

For banking sector, efforts have been paid to separate policy and directed lending from commercial lending. State Owned Commercial Banks are now given more autonomy on extending loans. These banks are allowed to say no to projects that they believe not commercial viable. In the recent months it was evidenced that the SOCBs denied lending to few mega projects that were proposed by State owned big business group. The move can be seen as more conservative credit policy and would help to prevent bad debts from reoccurring.

II. Institutional developments

Regarding insolvency intuitional respect, Vietnam is still in beginning stage. Insolvency are being dealt with mainly by formal solution – i.e, court informal workout solutions have not been used.

New vehicles for resolving distressed loans and assets were put into operation but results still limited. Currently, there are two type of Asset Management Company (AMC) in Vietnam: AMCs belong to commercial banks and the national Debts and Assets Trading Company that belong to the Ministry of Finance.

The forms of AMC were studied by Vietnam Government since 1998 with technical assistance provided by international consultants. In 2000, the Government has issued regulations regarding the establishment and operation of AMCs that belong to Commercial Banks. By now, there are 10 commercial banks have established their AMCs. The AMCs belong to commercial banks mainly focused on dealing, exploring, managing the mortgaged assets that transferred from their parent entities – the commercial banks – in order to recover the long outstanding NPLs of the commercial banks in question.

In addition to these banks' AMC, in June 2003, Vietnamese Government has also established a national Debts and Assets Trading Company (DATC) under the management of Ministry of Finance. The DATC has a chartered capital of VND 2,000 billions (about USD 127.4 millions) which is much bigger than those of commercial banks. It is the Government ambition to use DATC as an important mean to help the enterprises to resolve their long outstanding loans and distressed assets, improve the financial health. In the immediate period, DATC focuses on resolving the NPLs and NPAs of State Owned Enterprises. The life time of the DATC is undefined.

The DATC has officially started its operation beginning this 2004. DATC will pilot resolving the distressed assets and loans of 20 companies appointed by the Government. DATC has been dealing with (receive and sale) non performing assets of the State Owned Enterprise with historical costs of VND 270 millions (USD 15.4 million) and net book value of VND 71 billion (USD 4.5 million). The recovered amount after 8 months DATC in operation was VND 17 billion (USD 1.1 million). These accounted for a very small portion of the total debts and nonperforming assets of the State Owned Enterprises – currently estimated at VND 28,785 billion and VND 3,285 billions respectively.

The majority of debts of the SOEs , 72 per cent has been borrowed from commercial banks and credit organizations, while the remainder is owed to the state, other enterprises and labourers.

Official definitions and classification system of distressed assets needed: DATC will primarily deal with distressed debts and assets of the SOEs which have been outstanding for long time. The company will purchase/receive the debts and assets from SOEs or from other governmental agencies, not from banks. That say a normal classification of bank loans may not suitable for the purposes of evaluating and resolving the distressed debts and assets

The involvement of foreign investors in NPAs resolution is something being considered by the government. Although it was mentioned in some regulations but in practice – there have been no any cases where foreign investors purchased the NPAs.

Involvement of professionals were limited but being improved. Previously, the roles of professionals in insolvency were very limited. The number of experts in insolvency is small with limited expertise on this field. Many creditors have chosen to resolve the debts on their own. Recently, professionals (mainly qualified auditors and financial consultants) have more chances to involve in valuation of assets and corporations. The business and market are getting familiar with the involvement of the professionals. However, there is an indeed need to develop the profession in this fields.

As it is still in an early stage of operation, DATC needs to evaluate the distressed assets situation, enhance the skills of its staff, develop procedures and operating manuals, develop the strategy for NPLs and NPAs resolutions.

Dual and potential conflicting purposes: DATC has been established and is intended to operate for the dual, and potentially conflicting purposes reflected in its charter: (1) its social policy objective of cleaning up the NPLs and helping the SOEs get their financial situations sorted out; and (2) to make a profit, or at least be self-sustainable, by dealing in NPL-related transactions.

A new organizational structure to enable DATC to meet both objectives, but in two separate entities, might need to be established. One entity should deal with advising and establishing plans on restructuring NPLs and helping the SOEs get their financial situations sorted out, as instructed by the Government. This entity would be responsible for the purchase of NPLs under Government mandate. The other entity should be broadly engaged in the activities of the purchase and sale of NPLs, in market transactions and similar activities for the purpose of making profit. This entity would be responsible for the purchase and sale of outstanding debts and assets made at market prices through negotiation, auction or bidding.

II. *Current practices in various areas*

Thanks to the Government's efforts in undertaking reforms, the public's confidence in the Vietnamese financial system has been restored. The increasing number of players and types of financial services institutions on the market as well as the deepening monetization of the whole economy best illustrate the growing confidence. The five state-owned commercial banks (SOCBs), in particular the four large ones, continue to dominate the market with 80% of total banking assets and lending market share. Joint-stock banks (JSBs) and foreign-invested credit institutions continue to be important players on the market, while insurance companies are gaining ground.

Banking reforms continue with the recapitalization of the four large SOCBs and the JSBs as well as the resolution of non-performing loans (NPLs). According to the State Bank of Vietnam (SBV), NPLs totaled US\$1.1 billion as of Dec 2002, foreign analysts however estimate this figure to be much higher. The number of JSBs has been reduced to a total of 36 banks currently in operations.

The 4 SOCBs principal weakness is the low Capital Adequacy Ratio (Equity/Risk Assets) of an average 3.5% compared to the international standard of 8%. Credit remains the key business and source of income for the banks, although they strive to diversify into other products. The convergence of the banks' business strategies might be an impediment to their competitiveness in the future.

There have been significant efforts by the government to resolve NPLs. Out of resolved NPL from SOEs, 36% were paid out by state budget sources, 40% were dealt by risk provision funds and only 24% by liquidation of assets of the SOE debtors. There are still however very few NPLs sale and purchase transaction taking place. Although they have made progress on the resolution of NPLs, further efforts are necessary to clear the NPLs from the banking system. Prior to the reforms in the early 1990s, banking in Vietnam was largely monopolized by the State Bank of Vietnam, which was the country's main institution for deposit taking and lending. Lending was carried out by what were effectively four SBV departments – respectively focused on borrowers in the areas of international trade (exporters and importers), infrastructure, industry and commerce, and agriculture. In 1988, these departments were converted into four separate, autonomous, state-owned commercial banks (SOCBs), wholly owned by the SBV, currently - Bank for Foreign Trade (Vietcombank), Industrial and Commercial Bank (Incombank), Bank for Investment and Development (BIDV) and Agriculture and Rural Development Bank (VBARD), to perform commercial banking activities.

Since the late 1980s, important changes have occurred in the structure, the regulation, and the operations of the Vietnamese banking sector. Four large state-owned commercial banks still account for over 80% of the total assets in the system but they are now complemented by a number of Joint-Stock-Banks (JSBs), Joint Venture Banks, and branches and representative offices of foreign banks, and to a minimal extent credit cooperatives/credit funds, Microfinance Institutions (MFIs), and financing companies.

Over the past decade the 4 SOCBs have evolved from specialized policy-lending vehicles to more commercially oriented financial intermediaries. However, continued policy-lending practices throughout the 1990s, and limited credit assessment skills in the wake of rapid credit growth have led to the accumulation of non-performing loans (NPLs). To address this concern, the Vietnamese government has embarked on an important overhaul of the banking system through a multi-year restructuring and recapitalization program in 2001. The main

purpose of this restructuring program is to enhance the healthiness of the local Vietnamese banks' financials, i.e. increase legal capital of the state owned banks as committed with IMF/World Bank as well as increase the registered capital of the joint stock banks, provide a correct NPL calculation and bring down NPLs, allocate sufficient loan loss provision, and close down the problem joint stock banks.

Currently, the ratio of bank credit to GDP is about 50%. The growth of the non-banking financial sector, and especially of the issuance business, has been remarkable, even if the size of the sector remains small in absolute terms.

B. CURRENT RISK ASSESSMENT AND MANAGEMENT SYSTEMS AND POLICIES

I. Risk Assessment and Management Systems

Lack of transparency in NPLs disclosure. Disclosure of NPLs in Vietnam is very limited, remains far behind international standards, and until recently such information is considered a state secret.

Different criteria, classification system of banks loans used. Different definition of non performing loans and assets lead to the facts that the NPLs may be understated comparing to international standards. NPLs of banks have been variously reported ranging from 3% (as reflected in the official bank financial reports) or up to 30-75% (by some foreign analysts) of the total outstanding loans. Figures of foreign analyst were higher than that of the SBV since they calculation based on more stringent international accounting standard while SBV's based on Vietnamese accounting standard.

Prior to 2002, the banks only counted missed payments in medium and long-term loans as overdue. Starting from Jan 2002 Vietnam adopted a more rational loan classification based on a new accounting method, which classified the whole principal as overdue if a portion of the loan comes overdue. If a borrower fails to pay any amount of principal or interest and such amount is not extended or rescheduled, the total outstanding amount under the loan agreement (presumably including principal, interest, fee and any other amount payable) is classified as overdue debt.

The new overdue debt calculation methods will help bankers with better risk management but will drastically increase the ratio of overdue debts.

Loan loss allowance is not commensurate with the credit risk exposed. The banks are required to classify their assets into 4 groups every quarter and make provision to cover the risk. Currently, the 4 SOCBs are only able to follow the SBV regulation to classify their assets, but are unable to make the appropriate provision for loan loss reserve as required. The reason is because a very large portion of the NPLs were originated back in 1995-1998 and if the banks take out too much reserve, they will not have any profit and will not have to pay any tax, which the MOF & SBV do not want. The bank needs to have some profit in order to pay tax & also ensure that the employees' salary can increase a little bit, otherwise it will impact the human resource of the bank.

In Oct 2002 the SBV issued Decision 1154, which instructs the SOCBs to set aside loan loss provision based on the banks' financial results. Early in the year banks set a goal of a certain loan loss reserve made (LLR), which must be approved by SBV and MOF. Then by end of each year, the banks will take out that loan loss reserve as a lump sum. In case the financial result is better, the banks will need to take further LLR.

The 4 SOCBs hold the majority of NPLs in the banking system. Most of the bad loans that have accumulated are the result of soft policy loans to inefficient SOEs and occurred before 1998-1999. Since then as the SBV has applied stricter control as well as better risk management of commercial banks, new NPLs are about 2-3%.

According to State Bank of Vietnam, after a series of control measures, NPLs in the entire banking sector have been reduced from initially of 14% (or from 8.5% in 2001 (\$1.29 billion) to 6 % (\$1.1 billion) in 2002, in which NPLs of the 4 SOCBs account for almost 80% (\$865MM).

For the last 3 years 2001-2003, significant amount of bad loans has been resolved by the 4 SOCBs, via loan loss reserve write off and realization of foreclosure assets. Given the fortunate increase in the real estate price,

the banks have been able to recover a lot by selling the foreclosure assets. In addition, the SOCBs also allowed by the government to use the previous soft loan to write off a large amount of bad debts that were extended by SOCBs to SOEs who had been dissolved.

Moving towards an international standards in risk management. Vietnam continues the reform banking and finance sectors with a number of achievements have been made by the supervisory agency and the commercial banks. The State Bank of Vietnam is currently reviewing and the regulations pertaining risk management in light of Basel II requirements. They also has instructed State Owned Commercial bank to develop a credit manuals. Upto now, with the support of consultants, all SOCBs has developed comprehensive credit manuals sent to SBV for approval for subsequently implementation. The joint stock banks will also be requested to do so. These new credit manuals have been designed taking into account the international practices in risk management. To implement the credit manual successfully, there will need a significant training to be provided to bank staff and a good IT system.

Develop and implement credit manual together with other three activities (devise of business strategy; assets and Liability management; internal audit) would contribute a lot to the risk assessment and management system of the SOCBs.

Giving more autonomy to commercials banks: The government regulations were changed to allow the SOCBs to say no to projects that are not commercially viable. This would enable the banks work on a commercial basis and reduce credit risk.

II. Credit Information Systems

The Credit Information Center (CIC) was established under the State Bank of Vietnam to provide credit information of borrowers to creditors. This agency is being strengthened to in order to become crucial tools for banks to reduce risk of their future lending. Prior to 2004, the Center received and provided access to information to credit institutions only. From 2004, the center started providing access to interested parties in all economic sectors in return for fee. Type of information is also diversified, tailored to the needs on interested parties. There is currently no credit rating agency in Vietnam.

Conclusions and Recommendations

Box 1 Vietnam Financial Sector

Formal financial system

Banking financial sector:

- 5 state-owned commercial banks
- 4 large state-owned commercial banks:
 - *Bank for Foreign Trade (Vietcombank)*
 - *Industrial and commercial Bank (Incombank)*
 - *Vietnam Bank for Agriculture and rural Development (Agribank)*
 - *Bank for Investment and Development (BIDV)*
- 1 small state-owned commercial bank:
 - *Housing Development Bank for the Mekong River Delta*
- 1 Social Policy Bank
- 25 foreign banks branches
- 6 foreign bank sub-branches
- 40 foreign credit institutions representative offices
- 5 Joint venture banks
- 36 domestic joint-stock commercial banks
- Central People's Credit Fund System and 23 branches
- 888 local credit funds
- 7 Finance Companies (of which 5 are affiliates of General Corporations)

Non-banking financial sector:

- 18 insurance companies
- 8 finance leasing companies, 3 of which are joint ventures with foreign investors or wholly foreign owned: 5 are subsidiaries of state-owned commercial banks
- 1 Postal savings system, the Vietnam Postal Savings Service Company (VPSC)
- 1 Stock Exchanges: Securities Trading Center in Ho Chi Minh City, opened in July 2000
- 4 Investment fund
- 1 Debts and Assets Trading Company (DATC) established in 2003 belong to Ministry of Finance

Informal financial system

- Moneylenders, relatives and friends
- Rotating Savings and Credit Associations (ROSCAs)