

REPORT ON BANKING SECTOR

*Prepared by
Banking Working Group*

The first four months of 2013 has seen the continued success of the State Bank of Vietnam in monetary policy management, foreign exchange reserves and gold management.

The inflation problems of the past have been addressed, and is currently at a level that promotes stability. Liquidity of the banking system has significantly improved, and stability of the currency is well maintained and local currency lending interest rates continue to decline.

This macro economic stability is largely as a result of the policies and actions of the State Bank of Vietnam, and should provide a foundation to support sustainable economic growth in future years.

Progress has been made in other aspects of banking industry with some mergers and consolidation amongst banks, and the rollout of circulars (such as circular 2) which allows for Banks to define provisions that are closer in line with international practice.

The challenge of non performing loans in the system does not have a single solution. However, the establishment of the Asset Management Company will help towards addressing this along with the implementation of Circular 2. Whilst details of how these matters will be implemented are not yet clear, there is confidence in the State Bank that these issues will be addressed to support sustainable economic growth in the coming years.

It is with pleasure to report to the VBF that the working relationship between VBF's Banking Working Group ("BWG") and the State Bank of Vietnam ("SBV") has been cooperative and constructive. SBV has been providing opportunities for the BWG to provide comments and feedback on changes to existing and new regulations. In many cases the SBV has taken BWG's constructive feedback and revised regulatory requirements to make them more aligned with international best practices and to support healthy growth of the banking sector. Examples of the regulations and matters which BWG has provided comments/feedback during the last 4 months:

- Draft decree on AML
- Circular 04 on discount of valuable papers and financial instruments
- Circular 28 on bank guarantee
- Circular 02 on loan classification and provisioning
- Draft circular on account opening & usage replacing
- Draft circular on branch network of commercial banks
- Draft circular on prudential ratios replacing Circular 13 & 19
- FATCA

We highly appreciate the dialogue that SBV has provided to BWG and look forward to continue providing our support and contribution to the SBV in drafting regulations.

As mentioned in previous BWG report, we are strongly committed to support the SBV to achieve a healthy and restructured banking system.

With this in mind, we have set out this paper to highlight areas that are key and emerging (Section A), long standing issues that need addressing (Section B), and looking forward what areas we believe need to be focused on to develop the sector further (Section C). These issues have been discussed with the State Bank at a high level and at working level, and we hope progress will be made on them in the coming months.

SECTION A – KEY AND EMERGING ISSUES

1. Update of general banking license

Being aware of the conflict between existing banking licenses and requirements of Law on Credit Institutions, BWG has already presented with SBV on the matter, identifying potential legal & compliance risks faced by banks.

Concurrently, some members of BWG have already submitted the application to update their banking licenses to ensure that the license includes all the activities and services that they have been and will be conducting. SBV has recently issued an official letter to these banks saying that SBV will consider their applications after studying an overall solution for this matter.

As a result, BWG understands that while waiting for specific instructions from SBV, Credit Institutions (“CIs”) and foreign bank branches (“FBBs”) may continue providing products and services which are not included in general banking license or other sub-licenses but have been permitted by SBV in related regulations or in SBV’s one off approval to ensure business continuity.

We also suggest that SBV releases a directive clearly stating that every written acceptance of SBV for specific products and services or every sub-license is an integral part of the existing banking license.

This is absolutely necessary for business registration of these products and services with Business Registration Authorities (DPI) and helps to reduce time and efforts spent by banks on business registration.

The group recommends that the SBV considers cooperating with the Ministry of Planning and Investment to work out a mechanism that accepts the incorporation and operation license of 100% foreign-owned banks or FBBs as business registration certificate.

Derivatives License: Current banking licenses of banks do not mention derivatives, as a product or service. In practice, banks have been offering these products and services (e.g. commodity swap, interest rate swap and so on) in line with various SBV’s regulations or guidelines. The BWG respectfully suggests that SBV allows banks to continue providing these products while waiting for the license updates to be approved.

At the recent high level meeting between BWG and SBV, it was advised by SBV Banking Supervision and Inspection Agency that a solution for the above mentioned licensing issue has been proposed to the SBV Governor for review and approval and that SBV is taking actions to address this matter with high priority. We really look forward to hearing further development in this matter.

2. Draft Decree on Anti-money Laundering (“AML”)

The new draft decree on AML has requirements on beneficiary owners, customer identification requirements, which the BWG finds them not practical to be implemented and

therefore seeks SBV consideration for changes to be in line with international practices on AML.

We recommend SBV to change the requirement to identify “individuals holding from 10% chartered capital of a legal entity” to “individuals holding DIRECTLY from 25% chartered capital of a legal entity” since the latter is a common practice in many other countries.

We also suggest that SBV reconsiders the definition of ownership beneficiaries as “individuals holding from 20% chartered capital of an organization having more than 10% equity in a legal entity”, which is equivalent to a requirement that such individuals owning from 2% chartered capital of the legal entity.

This requirement is not only in conflict with the provision on individuals holding 10% chartered capital but also impractical to implement. It is suggested that this requirement is changed to “individuals holding from 50% chartered capital of an organization that has over 25% of equity in that legal entity”.

In addition, as stated in the Law on AML, customer identity verification is done on risk based approach. It is therefore recommended that SBV applies this approach in the draft decree and does not make it mandatory for identity verification on ownership beneficiaries who are corporate customers with low and medium risk profiles or recognized listed companies on the stock exchanges, for which customer identity has been verified by stock exchange regulators.

We have submitted our consolidated comments on this draft to SBV.

We have been updated by the SBV at the recent high level meeting that SBV will consider our recommendations in the next submission to the National Assembly.

3. Circular 02 on loan classification and provisioning

According to Circular 02 (Article 8), CIs and FBBs must request from Credit Information Center (“CIC”) a compiled list of customers of highest risk group; and in case customer risk rating of the CIC is worse, CIC risk rating is to be applied and loan classification & provisioning are to be adjusted based on CIC risk rating.

The BWG recommends that CIs are to use CIC risk rating for reference only because:

- (i) CIs have more updated and reliable information sources for risk assessment,
- (ii) Customers’ loan classification may depend on loan security and collateral arrangements at specific CIs
- (iii) Requiring CIs to rely on a third party – CIC – for loan classification purposes and in CIC’s way is contradictory with SBV’s permission given to CIs to develop their internal loan classification system at their own discretion; and
- (iv) Given the operational & financial difficulty, especially for consumer finance companies as explained below.

Furthermore, since the Circular 02 has new Articles stipulating technical issues regarding information usage from CIC, we respectfully request the SBV to further instruct at working level (Department level, CIC level) to ensure the compliance of CIs and FBBs.

Consumer finance companies currently have close to 1 million loan accounts; hence it is operationally impossible to double check the risk rating of of these accounts with CIC on

regular basis. Besides, this will have huge cost implication for involved consumer finance companies.

In addition, unlike the corporate loans, consumer finance loan is usually retail installment loans or stand-alone; as such, we believe that the application of CIC risk rating to consumer finance companies will not be much added value to the provision stance.

4. Internal auditor in charge of IT audit

SBV issued Circular 44/2011/TT-NHNN dated 29 December 2011 on internal audit and internal control, which requires that Internal Audit function must have at least one internal auditor in charge of IT audit.

We would like to request SBV to consider allowing for 100% foreign owned banks to use internal audit resources of parent bank to perform IT audit based on the following reasons:

- (i) This resource has qualification and knowledge on IT;
- (ii) IT system of the subsidiary is consistent with IT system and strategy of parent bank;
- (iii) This resource is specialized on IT audit, therefore has capability and experience in auditing IT for the subsidiary, ability to identify gaps in IT controls and recommend suitable solutions to manage risks;
- (iv) The use of this resource ensures compliance to professionalism requirements of auditors as required under Circular 44; and
- (v) Annual audit plan usually covers many business and operational activities outside IT aspects. It will be a waste of resource because the specialized IT audit resource can be used only for IT audit.

At the recent high level meeting with SBV, the BWG has proposed this matter again for SBV's re-consideration and it was noted by the SBV that this issue will be re-visited to make it more practical and efficient in line with international audit practice.

SECTION B – REVIEW OF LONG OUTSTANDING ISSUES

The working group respectfully recommends that SBV reviews and provides its guidance on *the matters raised previously*

1. Prudential ratios

The group has, in various occasions, provided input to the draft Circular replacing Circular 13 on prudential ratios. We are aware that this draft will soon be formalized within 2013 and very much hope SBV considers integrating the group's comments to the final draft.

SBV advised that many of comments from BWG have been noted and incorporated in the new circular.

2. FATCA – Foreign Account Tax Compliance Act

The BWG has written to SBV on this matter and still waiting for SBV guidance so that it could be implemented in Vietnam. As you know, the FATCA Act is applicable globally to any entities with a banking license issued in USA. As a result, all banks engaging in business activities in USA are subjected to this Act.

The BWG has also submitted to SBV legal advice we collected on the potential conflicts between FATCA and existing laws and regulations in Vietnam. Some group members have also submitted their requests for SBV's guidelines on this matter. SBV's review and

comments would be highly appreciated for adoption of FATCA appropriately in Vietnam as soon as possible.

Noting the timing of FATCA implementation is close, SBV advised that they will continue to follow-up with other ministries so as guidance and advice could be given to credit institutions.

3. Circular 28 on bank guarantees

The BWG has made its comments on Circular 28 on potential gaps and challenges for enforcement including the requirement of 3 signatories on bank guarantee letter, and recommended changes to this Circular. The BWG hopes to receive SBV's support and guidance so that banks can comply with this Circular in an efficient and practical manner.

On this matter, in the recent high level meeting with SBV, a working level discussion will be organized to discuss solutions for the matters raised.

SECTION C – LOOKING TO THE FUTURE

The BWG fully appreciate policy measures and actions that have been taken by SBV to stabilize the market and gain confidence from community in the banking industry.

Given the stable circumstance, the group would like to ask SBV to consider removing administrative measures in the following areas to allow the sector to develop further:

1. Eliminating the FX band
2. Allowing forward to trade without administrative restrictions
3. Allowing VND options
4. Removal of 30% capital limit on derivative notionals
5. Removal of interest rate cap
6. Allowing the netting guideline for offsetting positions or obligations in derivatives contracts.

We also wish that more transparency and information regarding banking sector restructuring be provided, which will help Vietnam in achieving a better country risk grade. The BWG is willing to act as ambassador for the SBV in this matter, and cooperate with any of the relevant authorities.

Conclusion:

Over the last 2 years, the SBV has made considerable progress in achieving financial stability in Vietnam, and progressing a restructuring plan for the industry.

As with many countries, there remains significant challenges and the BWG is committed to support the SBV in ensuring the sector continues to support the economic development of Vietnam in years to come.