REPORT OF CAPITAL MARKET WORKING GROUP

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SUMMARY

- Capital Market History
- Economic Overview
- Working Results with MOF/SSC
- Suggestions 5 Areas: SOEs, Foreign Ownership, Capital Markets, Debt Market, Governance
- Conclusion

CAPITAL MARKET HISTORY

The highly attractive macro story of Vietnam (population, median age, literacy etc) have been a magnet for Emerging Markets funds seeking the new "Asian Dragon".

Past

1990s Several funds were raised despite there being no stock market. The investments ended up in property or private equity and with the advent of the Asian crisis in 1997 were liquidated mostly at barely break even if not losses.

Successful implementation

2000s The second phase began with the opening of the HCM Stock Exchange in July of 2000 with just 2 listings. Subsequently more listings were added and the first equitisation occurred. This led to the boom in 2007 with the VN Index reaching a peak of 1170. Thereafter due to poor macroeconomic policies, the market plunged to a low of 234 in February 2009 and since then after a strong rally in late 2009 it has traded in a range of 420 to 520 into mid 2011and then plunged to 330 late in the year.

Current stagnation

2012 Earlier in the year it rallied to 490 to correct to 385. Not only does this volatility reflect a lack of investor confidence and institutional support but the current level remains the lowest from the previous highs in any Asian market except for Japan. Apart from Taiwan and Thailand (which were driven by excessive speculative bubbles) all Asian markets have surpassed their previous highs.

ECONOMIC OVERVIEW

Unfavorable Economic Environment

After a decade of impressive GDP growth in excess of 7 % pa, Vietnam hit the wall as unbridled credit growth (25-30%) led to high inflation and a weakening currency. The Government's focus was totally myopic focusing solely on growth to the detriment of fundamental economic principles and the safeguarding of the basic institutions that are the backbone of an economy and society. But unlike as in the Asian crisis of 1997 most countries accepted the pain of financial mismanagement and had the courage to swallow the bitter pill of reform viz. Korea, Thailand and Indonesia to name a few.

The collapse of Vinashin and the weak administration and financial management of most SOEs, concurrent with rising bad debts in the banking sector have damaged the image of Vietnam in the eyes of international investors. The credit rating of the country has deteriorated which made capital raising virtually impossible. The bad debts in the banking system are emerging as a big threat to the whole economy.

WORKING RESULTS WITH MOF/SSC

However, the Group would like to recognize the cooperation of MOF/SSC in addressing various matters relating to the capital market during the last few years; especially in 2012 when many suggestions from the Group were taken and addressed by the MOF/SSC.

Basically the MOF/SSC built up a comprehensive legal framework outlining the activities of the stock market. They presented to the Government the "Development Strategy of Stock Market to 2020". This covered many important legal documents such as the Guidance Decree of the revised Law of Securities; new circulars on information disclosure and corporate governance; launched new indices VN30; allowed margin trading, market orders and extended trading hours. The MOF recently issued a circular on open-ended funds and a paper to introduce regulations on real estate funds, pension funds and ETFs.

Regarding the bond market, after taking comments from the Group's members, the MOF required the SSC, State Treasuries and other government bodies to publish a calendar for issuing Government bonds andT-Bills at the beginning of each year which would help bond investors to establish investment schedules. The MOF constructed a legal framework to allow the merging of multiple small government bonds into one large bond to increase the size and liquidity of the market. T-Bills are already centralized at the Ha Noi stock exchange.

SUGGESTIONS - KEY AREAS

- SOE reform and Equitisation
- Foreign Ownership
- Stock Market issues (Trading bands-liquidity, opening an account, consolidation of brokers)
- Debt Market
- Improved corporate governance and transparency

SOE Reform and Equitisation

This is the most critical area for the successful development of the Capital Markets. Privatisation of State Owned Enterprises is not only the key to capital markets but also to enhancing the efficiency of the economy. There has been a great deal of noise and talk but little achieved since a good start in 2007. At the VBF 18 months ago Dominic Scriven the usual Head of the Capital Market Working Group, and for whom I am standing in today, stated that to speed up the process "a new roadmap with clear criteria and a detailed timetable" needs to be established. Why has nothing specific been published since then?

Equitisation is the backbone of sound economic policy and one only has to see what has been achieved in other Emerging Markets. The 2 principle industries that get privatized initially are Telecom and Banking. (2 banks have already been privatized and unsuccessfully due to mispricing). The key to a successful offering is VALUATION and the only way to achieve this is to hire independent advisers (reputed investment bankers) who can price and place out the issue in line with global industry standards and publish a prospectus that satisfies global investors' requirements. There is always the fear of selling State assets too cheaply and getting blamed but these are the risks involved in the process and ironically the most successful privatisations have been those where the stake holder has left a bit of money on the table to attract investors. Overpricing issues usually leads to failure and furthermore a substantial % should be sold to create a liquid after market, not single digit %s. Also managements should be encouraged to meet foreign investors.

Let's take BIDV as an example. The focus should be to sell off at least 30 to 40% with several foreign cornerstone investors, the issue being underwritten by leading global investment bankers. Not just 3 to 5%.

Equitisation should become the lynchpin of the Capital Market Group with the Government identifying 2 to 3 candidates to be privatised within the next 9 to 12 months. The process can no longer be a discussion point it must become an action point.

Furthermore SOEs should focus on their core lines of business and expertise and not diversify into unrelated sectors, which will only distract them from operating effectively and runs the risk of causing egregious losses. Proper discipline and consistency in planning are prerequisites to run, develop and privatize the SOEs successfully.

Foreign Ownership

In Emerging Markets foreign investors are a key element in fostering the growth of a stock market as they contribute much of the necessary capital for economic development. However it is appreciated that certain entities of such national importance need to remain in control by local interests most notably government owned companies. A way around this would be to create a class of share with no voting rights exclusively for foreigners, as in Thailand, but they get the economic benefits such as dividends. This would enable companies to attract much needed foreign capital. The bank foreign ownership limit should be raised to 49%, this would be a more realistic number.

Stock Market issues (Trading Bands-Liquidity, Account Opening, consolidation of brokers)

- *Trading Bands-Liquidity:* Despite extending the trading hours liquidity still continues to be an issue due to the % trading bands which restrict the natural movement of prices. Admittedly these % are there to protect investors from sharp falls but they encumber the natural workings of the market. A suggestion would be to impose a 30 minutes halt in the trading of a security when a move up or down of more than 10% occurs. Such a pause should bring stability.

- *Account Opening:* The current system is cumbersome and does not attract foreigners as it takes almost 6 months to open an account whereas in most other jurisdictions it only takes a week. The requirement to obtain judicial status and a non criminal record from the country of origin of the account holder proves to be time consuming and costly. This should be replaced by the simple requirement of a notarized valid passport. This would attract many more foreign investors and most importantly capital into the stock market.

- *Consolidation of Brokers*

  The Group and MOF/SSC have discussed and agreed that, currently there are too many securities firms (105 companies) for the Vietnam stock market of which the top 10 companies hold more than 50% of market share. The remaining companies are small and cannot operate profitably. Many securities firms are almost inactive with incurred losses destroying shareholders' equity and putting at risk bona fide investors who open securities account at these firms. The losses incurred by securities firms are mainly due to proprietary trading, excessive borrowings and incautious margin lending while the risk management is weak. Thus, the Group suggests:

MOF/SSC need to accelerate the restructuring process of securities firms in order to reduce the number of firms, focusing on improving quality and financial capacity which should result in a healthier market. SSC needs to supervise and enforce compliance of the regulation that requires segregation of the investor's asset and firm's asset by securities firm.

MOF/SSC should regularly check the financial capacity, corporate governance and risk management of securities firms in order to ensure safety of the overall stock market and investors' interests.

Debt Market

The country's bond market is still very small and liquidity is low. There should be a focus on developing:

- *The Government Bond Market:* A proper functioning bond market with defined maturities (3, 6 and 12 months, 3, 5 and 10 years). There should be a clear calendar for the auctions. There should be a few designated government authorized dealers dealing amongst themselves and not on an Exchange; this would encourage a more orderly and liquid market. To attract foreign investors the 10bps transaction tax MUST be abolished. It is senseless and generates no revenues; on the contrary foreign investors would bring much needed funds to the government.

- *The Corporate Bond Market*: There should be a focus to develop a corporate bond market, with fixed coupon issues, zero coupon issues and convertible issues. Such vehicles would suit local insurance companies and foreign fixed income funds.

  Going forward the Group suggests the MOF/SSC focus on the establishment of a credit rating so that risk levels can de better defined.

Improved Corporate Governance and Transparency

Though the current legal framework basically regulates public disclosure and corporate governance areas, in practice, many companies do not adhere strictly to these regulations causing concerns for investors. The Group suggests the SSC increases supervision, investigation and makes strict penalties for violations in order to enhance law enforcement and promote a greater awareness for market participants.

An economic calendar should be published on a timely basis to be made available to investors with collective macro indicators from various formal sources such as GSO, SBV, MPI and MOF/SSC.

The research reports by securities firms need to disclose fully, truthfully and objectively any potential conflict of interests. For example, the securities firm or the author of the report himself may own shares or have related party benefits with the subject company of the report. Such information must be disclosed openly and transparently.

Conclusion

Vietnam continues to have a great macro story, 90 million population, median age 27 and 93% literacy rate great ingredients for future growth. We have to look at what went wrong. There was too much focus on economic growth and unbridled credit growth (30% at the peak), which inevitably led to high inflation and currency depreciation. Similar characteristics that led to the Asian crisis of 1997 which was resolved in 2 years with the most vulnerable countries taking their pain through bankruptcies and cleaning up bad debt. This is not being addressed in Vietnam. Yes inflation has been brought down from 23% to 9% and the currency has stabilized but there continues to be a reluctance to address the real issues of the banking system and reforming the State Owned Enterprises (SOEs). Until these issues are addressed it will be difficult to achieve sound sustainable economic growth.

Regarding Vietnam I don't want to be an apologist but rather a realist and remain a long term supporter. The underlying will to succeed is widespread throughout the population, but is hampered by the corrosive prevalence of corruption, which has not been contained and is not even pragmatic as in other Asian countries. Until effective sanctions are put into place, policy will continue to drift. A wake up call is needed. Don't get me wrong I am still a big believer in Vietnam.

In conclusion it is often darkest before dawn and as in the Chinese language script, the word for chaos also means opportunity. Change is inevitable hopefully for the better.

Vietnam has a challenge, TO DELIVER.