Chapter 3

REFORM IN THE BANKING SECTOR

This chapter has made an appraisal of the banks and financial sector reforms undertaken so far, especially after economic crisis affected Southeast Asia. It considers what must be done - both in the short and medium term - to create vibrant and healthy banks and financial sector. The chapter concludes that sustainability of the Banks' short term recovery, as well as its long term economic prospects, depends largely on how effectively and comprehensively the banks and financial sector are restructured.

Vietnam's banking system has had problems common to many countries in the region. It was suffering from unproductive loans, poor management practices, and perceptible gap between savers and investors. Recognizing this situation, restructuring and a program of reform for the banking sector aimed at restoring the financial health of banks were undertaken.

Shifting Banking Activities into Commercial Operations

Due to prolonged inflation, originating from serious imbalances in the national economy, the monetary and credit operations in the 1980s were very confused and mixed. Bank note issuance was of great volume. The volume of cash issuance was greater in the following years but the cash supply remained short to meet with the monetary demand for production and services. The figures have shown that much of the cash that had circulated in the market had not returned through the banks. So issuing bank note was to cover cash shortage in the market. The banks could not function efficiently as cash centers. The Banks were unable to control cash circulation in the market and that had negative impact on socio-economic life. This was largely due to misunderstanding on cash flow. It had to be considered as a component of monetary circulation - a part of total payment facilities. The banks prepared inadequate cash volume to maintain liquidity for depositors at the banks.
In lending activity, particularly, the outstanding short term loans rapidly increased, breaking all quarterly, annually planned target and gradually escaped from raised funds. Credit growth rate was far beyond the development rate of production and services. But in substance, the lending activity remained heavily on the state budget. Contradictorily, the lending rate was usually lower than deposit and saving rate. All branches of the SBV (Central bank) only provided loans and were considered as the major funding sources. The share of funding volume in lending amounts rose significantly and the central bank discharged its functions as the issuer and the lender. Loans became the major earning sources of State Owned Enterprises (SOEs) and SOEs revenues were heavily dependent on the state budget as more loans - more incomes and more deferred payments - more profits as well. The Central Bank – the government representative, responsible for fund management was the main loser due largely to the fact that the fund was gradually smaller in volume, scattered in lending and lower in value (domestic currency depreciation and devaluation). That led to high inflation rate and return to the banks was somehow impossible.

Due to greater volume of the cash in the socio-economic activities, non-cash payment through banking system was reduced significantly and cash payment became more popular. More or less, it was considered as cash-based economy and so the functions of the Central Bank as state monetary manager and controller in the national economy were restricted. Business transactions were generally conducted on a cash basis. Cash transactions and a large share of monetary earning bypassed the formal banking system. Deposit no longer remained at banks. The linkage between cash and deposit were broken and payment through banks’ accounting system was less.¹

This picture had been continuing from organizational establishment of the banking system, since its birth, the central bank had been performing both functions as issuing bank and lending bank and as State controller on monetary payment and lending activities. The monetary market was not formally organized in the centrally planned economy (command economy). The banking operation was relatively simple. There was no market demand as dynamics. The major role of the bank was to act as the agent of the government to finance different sectors of the economy after fund allocated by the central government.

The State management in one tier banking system forced its branch network to follow tightly central government instructions and commands in various areas of banking operations.

¹ Vietnam Banking System – the process of growth and development, National political publishing house, 1996, p 260
In lending activity, there was perceptible constraint on fund raising for loans. In fact, the lending activity were linked with the central government plan. If more funds were provided by central government, then more loans were provided through the banks, whereas, the retail and banking services had no opportunities to improve and the banks were impossible to operate commercially. Needless to say that customer services and credit culture were not satisfactory.

Generally, the requirement conditions for banking activities at that time were insufficient and of course, this reason forced the banking system to change its operations into a consolidated accounting system as required by the market economy.

The directives for banking reform were early identified and expressed in the party’s resolutions and in the government’s decisions:

-Make a strong change in the banking operations, shifting policy-lending From banks to a state budgetary-fund and creating a market-oriented Credit culture.²

-Besides its duty as monetary controller, the State Bank of Vietnam was required to develop its banking system for specialization in lending activities and banking services and operate commercially³

-Strengthen the SBV to discharge its functions as State manager and Controller on monetary and lending activities. Develop the specialized banks so as to operate commercially on monetary, lending and banking services.⁴

From the above directives, in mid 1987, the chairman of the Council of Ministers (Prime Minister) allowed the SBV to test the change of banking operations in some cities and provinces in order to have experiences and fulfill banking operation mechanism to submit the Council of Ministers for approval at the beginning 1988.

On 25 June 1987, the Governor of the SBV issued the decision No 59/QD to permit the SBV – Ho Chi Minh City branch to try the change of banking operations from 1 July 1987.

² Resolution of the 8th Party Central Committee conference (5th Committee)
³ Political report at 6th national congress of the communist party
⁴ Resolution of the 2nd Party Central Committee conference (6th Committee)
SBV Ho Chi Minh city branch was not only monetary manager of the Central bank located in Ho Chi Minh city but also a commercial bank in turn. It discharged both functions: monetary management and commercial banking so it became a state owned specialized commercial bank - a commercial bank had legal entity specialized in monetary and lending operations on the territory of the city and its branch network covered all parts and districts of the city.

But in reality, the performance of the SBV improved only marginally. Some legal issues remained unresolved:

- There was no independent asset, right on independent asset autonomy;
- There was no identification of its own working capital;
- There was no compulsory reserve requirement by the central SBV.

- With central SBV, it was only one-way relation as only capital and cash were provided by central SBV. In money term, there were no loans or discounting activities from central SBV. SBV Ho Chi Minh city branch was entirely subsidized by the central bank.

- Customers (enterprises and economic units) network were not properly formulated. Customers network were given by central SBV and it was difficult for SBV Ho Chi Minh city to operate commercially in expanding customer network and diversifying banking products and services.

In July 1987, the first joint stock bank, namely, Ho Chi Minh City Industrial and commercial bank was established. This was the effort of the Governor of The SBV together with the Chairman of Ho Chi Minh city people’s Committee for establishment of a first joint stock bank with a legal entity and independent accounting system; As a commercial bank, it operated commercially in the Vietnam banking system and under the SBV and Ho Chi Minh city people’s Committee. Its banking performances were regulated by the SBV policies, and serving for economic development programs in Ho Chi Minh City.

The initial capital of Ho Chi Minh City industrial and commercial bank was 600 million Vietnamese Dong (VND). The SBV shared 300 million VND and the shareholders shared the rest. The bank was allowed to issue 6000 stocks and each stock denominated 50 000 VND. During its banking performances, if city development plan was required by Ho Chi Minh city people’s Committee and approved by the SBV, the bank could issue more stocks so as to increase the
capital base. The stock could be transferable upon the acceptance of the its Board of Directors. Ho Chi Minh city Industrial and Commercial Bank was allowed to raise joint stock funds from State owned enterprises, collective economic units and among individuals but the state owned shareholders were not allowed to use state budget and bank loans to purchase stocks.

Main functions of Ho Chi Minh City industrial and commercial Bank were as follows:

-Receive deposits (demand and term deposits) from government agents, State owned enterprises, collective economic units, private enterprises and individuals.

-Provide short-term loans (working capital) to all economic units located in Ho Chi Minh City. In addition, upon availability of its capital resources, the medium term lending could be provided to improve technology, and expand production serving for economic development programs of the city. The bank was allowed to have shares with other economic and production units under the form of joint venture (JV) or business cooperation contracts (BCC).

-Upon requirement of fund use to be more than working capital, Central SBV could provide loans to the bank according to SBV lending schedule. Additionally, the bank could also obtain re-borrowings under discounting method from central SBV. It depended upon availability of SBV capital and the bank effectiveness.

-Ho Chi Minh city industrial and commercial bank is under the control and supervision of the SBV. Its duty is to report to the central SBV by delivering balance sheet, accounting report and other banking operation reports on monthly, quarterly and annual basis.

-Non cash payment as fund transfer, checks, clearing etc are introduced to its own customers but the clearing between the bank and its customers is through the deposit account of the bank opened at the central SBV.

-Based on the general guidance, norms and regulations of the central bank, Ho Chi Minh city industrial and commercial bank can regulate its own banking operations consistent with its geographical location and its own operating environment.

-The bank is obliged to pay tax both capital and outstanding tax and income tax to the State budget. The rate is defined by the Governor of the SBV.

In 1987, there were two kinds of commercial banks in Ho Chi Minh City operating in different ways, including SBV branch and Joint Stock Bank (JSB).
SBV Ho Chi Minh city branch was in the initial stage to introduce commercial banking, while improving some certain procedures in commercial banking, but the legal issues remained for shifting it to become a commercial bank. The joint stock bank - Ho Chi Minh City industrial and commercial bank were not allowed to expand fully its banking operations so as to become a commercial joint stock bank in a real term. It was gradually liberalized in the banking reform program.

Given by the policy, SBV Ho Chi Minh city branch was allowed to operate as a commercial bank, but in reality, that was commercial banking operated by the central bank through its branch in Ho Chi Minh City. In fact, SBV Ho Chi Minh city branch’s performances were not commercial banking operations as a fully legal entity. In substance, it was a kind of commercial bank in the transitional period from centrally planned economy to market economy.

Applicable to the joint stock banks, the regulations at the time did not create necessary prerequisites to create sufficient relations between the central bank and joint stock banks. Compulsory reserve requirement was not regulated by central SBV to joint stock banks and in turn, the joint stock banks could not apply for re-borrowing on discounting basis at central SBV. Moreover, joint stock banks could set up loan procedures, regulations and mechanism for settlement in the case of disputes of their own.

Two tier Banking System as the First Round of Banking Reform

After these two bank models were tested for a certain time in Ho Chi Minh City, the council of Ministers had issued the decree No 53 under the principal orientation “moving definitely the banking system into commercial banking”.

The following are the first round of actions of banking reform:

a. Restructure the SBV – the central bank to become a part of the government and to perform the functions of control on monetary and credit activities while strengthening management and supervision of banking operations.

    SBV is a sole issuing bank of the government; being government controller on monetary and lending activities, and government manager on foreign currency, gold, silver and precious stone reserve as well.

    SBV issues monetary policies and regulations and supervises the implementation of monetary, credit and payment activities on the whole of the
banking system. The SBV is not involved directly in business transaction with producers, trading, and economic enterprises. SBV banking operations are focused on macro economic performance. The customers of the state bank are the commercial banks and financial institutions. The credit activities of the SBV are done through deposit from commercial banks and the SBV pays them both principal and interest at maturity.

b. As state manager and controller in monetary market, the SBV takes into account all issues related to macro economic performance both domestically and externally. The establishment of commercial banks with their independent accounting system depends on SBV branches located in provinces and cities. It is entrusted to look after state management and monetary operations.

Commercial banks could provide short-term loans for servicing production and business activities; for instance, the Bank for Investment and Development of Vietnam (BIDV) can provide both short term and long-term loans. The medium term loans were provided for infrastructure development, technology improvement, and production expansion. In addition, the loans could be provided for share holding with other business or production entities, and for issuing stocks to absorb more investment inflow.

The principle – effectiveness and liquidity was the aim and target of the banking operations and it had an active impact on business consolidation of all economic entities. The commercial banks had to maintain cash payment or fund transfer for customers at their request. This business transaction was generally conducted on a cash basis. Cash management, and cash payment were regulated tightly by the SBV.

c. Main linkage between SBV and other commercial banks were borrowings or fund deposited with interest. It was performed by credit schedules submitted by the commercial banks to SBV on quarterly, semi-annual or annual basis.

If the fund use was higher than the planned capital provided by the SBV, then the commercial banks could request for re-borrowing on discounting method, for term loans, or for other certain loan agreements. SBV re-capitalization was dependent on its reserve and deposit growth, whether SBV could meet the demand from commercial banks or not, it was heavily dependent on the market. The SBV regulated the compulsory reserve requirement of the commercial banks’ paid up capital (own equity).

d. The SBV issued general regulations on credit, cash and payment etc. for uniform practices. In turn, the commercial banks prepared their own regulations and guidelines applicable for their banking operations. The payment was introduced flexibly in their environment.
e. The commercial banks introduced their own accounting system and were responsible for their banking performance and for taxation including outstanding capital, term loan etc in each period. The SBV governor decided their contribution to the state budget as percentage.

Commercial bank profits were allocated as follows:

-10% for risk fund
- The rest 90% was allocated as bellow:
  - Payable to central state budget 40%
  - Payable to local state budget 10%
  - For various funds 50% of which banking development: 40%, governor fund: 2%, sector welfare fund: 3%, reward fund: 35% and 20% for its own welfare fund.

f. The salary of the banking staff have has been gradually improving, according to the resolution of the second conference of the 6th central party committee that to maintain the salary equal with the rate of October 1985 after balancing the cost and profit. i.e. the return after deducting the cost and tax can divide to the total employees according to different job descriptions.

g. Strengthening organization and the bank staff in the banking reform was required to base on the following principles:

- Separate the state function as monetary, credit and payment controller of the SBV from commercial banking and services of the commercial banks.
- Strengthen consolidated management role of the SBV and develop active commercial banking.
- The network should be effective, dissolving unnecessary intermediaries and unnecessarily limiting the banking operations within administrative and geographical boundaries.
- The banking organization should match the economic requirements and features of the whole country in general and of the sectors and regions in particular. However, active and appropriate steps should be applicable to
accelerate production, business, and service without any barriers to economic activities.

From the above principles, the initial stage of the two tier banking system was formulated as follows:

Reorganization and stabilization of the SBV was done during two years 1998-1999. It was proposed to reduce the number of provincial and city branches of the SBV and establish some regional banks as representatives of the central bank based on localities. This was done through the establishment of SBV Ho Chi Minh city branch.

Development of the commercial banks:

The Bank for Foreign Trade of Vietnam (VIETCOMBANK) should be equitized to become a joint stock bank.\(^5\) The bank was responsible for their own banking operation with its own accounting system and profit and loss, servicing for imports and exports, foreign exchange operations and international settlement. The bank could issue its stocks for fund raising and share its fund in domestic and foreign trading companies. Upon request, the bank could be allowed to establish representative or operation offices in foreign countries.

The Bank for Investment and Development of Vietnam (BIDV) - former name: the Bank for Investment and Construction operated commercially in short term, medium term and long term credits. These banking services existed for construction sector. It disbursed its own equity and raised funds including shareholding funds, funds raised in foreign currencies from Vietnamese overseas and foreign institutions.

BIDV operated commercially like VIETCOMBANK with its headquarter in Hanoi and branch network covering all parts of the country. Apart from the management of the BIDV system, BIDV headquarters could have direct transactions with customers from central agencies and in Hanoi. Its branches were located in the economic and commercial areas where there were many construction works or key constructions of the state.

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\(^5\) This is only the orientation. In fact, the shareholders were not identified except the State Bank of Vietnam.
Establishment of new agricultural, commercial and industrial banks.

In each city, province or special zone, a commercial bank was established. The name of the bank depended on areas of economic activities. In the major cities: industrial and commercial banks were set up, in the other provinces: agricultural, industrial and commercial banks were established.

In a short time, district SBV branches were changed into district branches of the commercial banks. In the rural districts, it was named as branches of agricultural bank, in the townships and provincial towns; it was named as branches of the industrial and commercial banks.

The name "Bank for customer services" as given in the decree No 65 of the Council of Ministers was not applicable to the funds. The "saving funds" were introduced appropriate to people perception. At central SBV, there was only one function to manage and guide saving operations. In cities and provinces, there were city and provincial saving funds. Its network consisted of district saving funds and saving counters were opened wherever necessary. The post offices were gradually authorized by the banks to receive and return savings. This aims to reduce a number of saving staffs and saving counters and creating favorable conditions to the depositors.

Establishment of the city, provincial gold and silver trading companies

These companies conducted gold and silver trading and the services concerned. As a trading company, it operated commercially and under branch director of the commercial banks. The companies had shops wherever appropriate.

- Strengthen and develop credit cooperatives in order to perform well rural credit and monetary operations. The credit cooperatives were responsible for their own costs and operations. SBV regulated credit cooperatives in terms of policies, procedures and operations. The cooperatives also established relations with district commercial banks in terms of deposits, trust funds and loans under the interest rate policy of the SBV.

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6 At the time, at the central level, the Headquarter of the agricultural, industrial and commercial bank was not established for its system management.
During period 1986-1987, capital demanded by the economy was very great, particularly, when the public policy was in favor of boosting production and businesses. In that context, the banks could not respond the capital demand of the economy and this was the main reason for spontaneous establishment of the urban credit institutions. During 1998-1999, together with shifting the banks to operate commercially, 7000 credit cooperatives and economic units also raised funds and provided lending under different names: Credit cooperatives, Credit centers and non-state owned banks etc. In some parts, the process of establishment was spontaneous and somehow like a campaign. The statistical figure has shown that at the end of 1989, there were approximately 7000 rural credit cooperatives, 500 urban credit cooperatives and 17 non-state owned banks.

At the time, the SBV management and control was not regulated accordingly. So the control could not catch up the development of these credit institutions. The market interest rate was not managed and adjusted. These credit institutions had absorbed a great volume of cash and capital not only in their areas, but also extended to other geographical locations by introducing very attractive interest rates. The illegal operations of these credit institutions were only for their profit purpose, and were characterized as cheating in action.

Starting point was bankruptcy of Thanh Huong Perfume Enterprise - a producer, not a bank, that raised funds by cheating popular deposits. This led to a series of collapse in terms of monetary operations, and made negative impact primarily to credit cooperatives in Ho Chi Minh City and later to Hanoi and other provinces. Initially, only some credit cooperatives had signaled shortage of liquidity funds, then, at the highest level, bankruptcy occurred with the credit center XACOZIVA based in Binh Thanh district, Ho Chi Minh city (March/1990). Successively, DAI THANH, ANH DAO and a series of credit cooperatives and centers in turn fell into incapable liquidity and were bankrupt at a later stage.

In the urban areas, in first quarter 1990, there were only 180 among 500 credit institutions that were lacking in liquidity. But at the end June 1990, the number increased to approximately 400 credit institutions. Up to 20 November 1990, only 18 credit institutions had no financial problems, more than 100 credit institutions were facing financial constraints in liquidity and the rest were in
The status of bankrupt. The total working capital was 862 billion Vietnamese Dong (VND) in which 83 billion VND was their own equity, and the rest – 741 billion VND were raised from population. These credit institutions lent 791 billion VND (loan outstanding) in total, of which over due loan was 510 billion VND accounting for 64.47%. At the end of 1990, majority of credit cooperatives, credit centers and non state owned banks coped with many difficulties in term of liquidity due largely to non payment from lending - both principal and interest.

In the rural areas, there were more than 7000 credit cooperatives that faced a lot of difficulties in their operations in the past. Over 70% of these credit cooperatives operated as saving agents for the SBV. In the circumstance of “Negative” interest rate as lending rate was lower than borrowing rate, there operations were reduced significantly and majority of credit cooperatives were either going to close or were in the status of incapable liquidity.

The above situation of non-state owned financial institutions was a matter for grave concern. It had negative impacts on the economy as also on socio-politics. The two banking decree laws were issued in that context. It was required to solve serious problems in the banking sector and to restructure banking system into two-tier market-oriented credit system under state control and management. The Government of Vietnam, The SBV and other sectors and localities made their efforts in this regard. Series of documents were issued for solving problems, but it took a lot of time and efforts and problems remained unsolved up to present time.

After 5 years of implementation of the banking decree laws, new license was granted to only 10 of 15 joint stock banks, and the other 5 banks was liquidated. Majority of rural credit cooperatives, credit centers and urban credit funds were forced to stop operations and were closed by competent State Authority.

In 1986-1987, four states owned commercial banks were established by the SBV. They were: Vietnam Industrial and Commercial Bank (Vietincombank), Vietnam Bank for Agricultural Development (VBAD), also known as Vietnam Bank for Agriculture and Rural Development (VBARD), Vietnam Bank for Investment and Construction (VBIC), now renamed Bank for Investment and Development of Vietnam (BIDV) and Bank for Foreign Trade of Vietnam (INCOMBANK). These banks had duties to develop commercial banking operations and to solve the residual problems of the banking sector in the past.

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7 Vietnam Banking system-the process of development, Publishing house 1996 p 276
During 1988-1990, these state owned banks faced many difficulties:

- Non cash payment transactions were very weak. In term of domestic payment, cash was required for payment, but there was shortage of cash and capital at the banks, even cash was insufficient not only for salary, for payment and allowances, but also for social subsidy and purchase of agricultural products.

- Lending amount mainly for state owned enterprises increased fast and many loans were not collected both in terms of principal and interest. Overdue loans accumulated heavily up to thousand billion VND. Up to 31 December 1991, the overdue loans of state owned commercial banks accounted for 19.8% of the total loans.

- Unhealthy financial status accumulated for years was not solved which created a great burden for each bank. The paid up capital for each bank was 200 billion VND, which was not provided by the state budget. At the end of 1991, the paid up capital of these 4 state owned commercial banks were only 16% of the registered figure. The fixed asset in money term remained approximately 200 billion VND. Only Bank for Foreign Trade of Vietnam got relatively small profit, which all other banks sustained losses. Four States owned commercial banks had to take loans from the SBV. Of which, SBV Loan for Vietnam bank for Agricultural development accounted for 50% of the total capital; and the figure was 29% for Vietnam industrial and commercial bank.

Banks’ Organization and staff were ineffective, customer services were very Complicated, cash and counter tellers behaved impolite and uncivilized to customers.

The heavy consequences of the subsidy system, the weakness of the state owned commercial banks and the collapse of the credit funds made the banking system loose its confidence among population. During this period, many legal violations took place and which resulted in punishment to 2000 banking staff. About 200 bank managers were sentenced to jail.

FUNDAMENTAL AND OVERALL RENOVATION OF THE BANKING SYSTEM

In order to follow the resolution of the 6th National congress of the communist party of Vietnam, the Council of Ministers (government) issued the
decree 53 in which it had pointed to shifting banking activities to commercial operations. To move gradually from the centrally planned economy into market oriented one has proved difficult. Thanks to new mechanism, the production had initial growth, and overall picture has changed considerably.

The decree 53 highlighted the introduction of the two tier banking system in the market-oriented economy, new forms and new ways of fund raising and fund transfer were applicable. The banks operated commercially in the competitive environment of the market economy. This was a great change in the monetary and credit operations. This helped to stop the prolonged inflation and the dependence of the state owned enterprises on state subsidy. However, owing to experience constraints at the time the decree could not address the position, role and significance of the monetary market as well as functions of various kinds of the banks in the banking system. Therefore, the decree 53 and its development could not comprehend fully the implications of the two tier banking system. This period was considered as a test for banking operation in the market economy.

The initial trials have shown the prospective perception and monetary operation potential, but it also revealed many weaknesses. A special attention was made to the macro economic performance. The following shortcoming required the banking system to have fundamental changes:

- Monetary policy was new concept in the new environment and there were practically no instruments to implement the policy. State management and commercial banking were not properly understood. Commercial banks were not under the control of the state management and the latter were unable to interfere with the functions of the commercial banks.

- Lack of many instruments for the capital and monetary markets.

- Banking products and facilities were not updated and developed effectively.

- Two tier banking system was not definitely separated. It still overlapped and crossed in organization and structure.

- Banking inspection and supervision instruments were very weak to provide securities for both depositors and banking system.

This renewal process was considered as a quantitative test for qualitative changes at the beginning 1989, as new position was opened for macro economic performance.
In view with the difficulties of banking operation, following conditions were created:

- Uniform practices of the domestic market;
- Prices were stable and on the same pricing system;
- Economic competition was encouraged;

In view with the decree 53 and new experiences, good opportunities were opened for overall change of the banking system. This was a turning point to avoid inflation, gradually coming towards stability through the performance of economic and monetary policies and state macro management institutions.

The success of the economic renewal was based on development of multi sector economy, expanding external economic relations, foreign direct investment (FDI), and overall reform of the banking system. This was a good opportunity to have overall changes in the banking system, partially contributing to inflation control and stability of the economy and creating favorable conditions to join international community in the future.

The banking decree laws paved the way for the banking system entering into market economy and it was considered a turning point in the renovation of national economic management.

Following implementation of these banking laws, many key areas in the banking system have been changed fundamentally. The central bank's position, role and functions changed and it was different from commercial bank system. In the past, the SBV in the centrally planned economy performed both functions: state management and monetary operations with production and trading enterprises. According to new banking laws, the Central Bank was confined to only state management. Its main responsibility was to maintain monetary stability and the purchasing power of Vietnam currency (Dong).

The second tier banking system including not only state owned commercial banks, but also joint stock banks and other credit institutions operated commercially in terms of monetary and banking operations, servicing entities, enterprises and individuals to gain profits. It was projected that the commercial banks would create a healthy monetary market, and operate competitively with many forms of ownerships both domestically and externally.
The state owned commercial banks did not perform function of the monetary policy management. It performed only the monetary operations with its key roles in the banking system. The state owned commercial banks were reorganized by the decision of the government and the governor of the SBV promulgated their statutory articles.

The joint stock banks and credit institutions have emerged in the recent past. The proposals for establishment of new banks were considered carefully by the SBV for granting license. A part of foreign banks were granted license either to open branches in Vietnam or to join joint venture banks.

At the end of December 1995, the Vietnam banking system included:

i. Central Bank - SBV with its headquarter located in Hanoi and 53 branches in cities and provinces. At the end of 2001, the number of branches increased to 65, due to establishment of new provinces.

ii. Commercial banks and financial institutions:

  o Four States owned commercial banks and one policy bank – bank for the rural poor, established in 1997.

  o 51 joint stock commercial banks with network of hundreds branches including 31 urban joint stock banks and 20 rural joint stock banks. In 2001, this number was reduced to 46 in banking reform program: four joint stock banks were closed and the other two joint stock banks were merged.

  o Two joint stock financial companies and now this number increases to 6 financial companies.

  o Four joint venture commercial banks

  o 19 Branches of foreign banks now it increases to 21 foreign bank branches

  o The system of people’s credit funds and credit cooperatives.

  o 576 grass root people’s credit funds, three regional people’s credit funds, and one central credit fund.

  o 64 credit cooperatives.
In addition, there were 67 representative offices of the foreign banks and financial companies from 21 foreign countries operating in Vietnam.

The commercial banking system and non-banking financial institutions would be developed quantitatively and qualitatively and on the scale of operations in conformity with the development of the national economy.

The state-owned commercial banks had dissolved the intermediary management levels and were linked closely with the administrative boundaries of the cities and provinces. It realized the centralized management model based on the creation and relative independence of its branches, establishing subsidiaries for new banking services. Its own management decided management and guidance of the commercial banking operations and norms for proper banking performances. The branches network of the state-owned commercial banks were located in the industrial and commercial centers. Particularly, the Bank for Agriculture and Rural Development were diversified and mobile counters appropriate for better services to rural households were introduced. The SBV was equipped with the function of macro management of monetary system of the whole country. The SBV is authorized to take steps for the following:

- Inflation control, maintaining the stability of purchasing power and contributing to economic growth.

- Introduction of macro instruments for monetary policy performance in each period such as compulsory reserve requirements, credit limits, re-lending interest rate, and open market operations.

- Establishing and strengthening support institutions for target monetary policy performance as inspections, and supervisions.

*Monetary policies in the market economy include Credit policy, foreign exchange control policy and state budget policy. That is closely linked to cash flow channels in circulation.*
Credit policy

Credit policy of Vietnam is aimed at the following objectives:

- Perform positive interest rate policy (move from negative interest rate to positive one)

- Expand Credit activities to all economic components: Credit was not only provided to state sector economy, but also expanded to non-state sector and individuals.

- Change credit structure: reducing the short term credit while increasing gradually medium and long term credits.

- Improve credit quality and efficiency: monitoring and eliminating credit exposures and risks.

- The commercial banks were allowed to operate banking for multi sectoral economic activities. No constraints for specialized commercial banks as applicable to the bank for agriculture of Vietnam whose target customers were not only farmers, but the industrial and commercial customers also.

- Gradually apply the co financing activities in credit activity and credit guarantee.

From 1990, the negative interest rate moved up to positive one and from June 1991, the positive interest rate was introduced accordingly in the credit activity. The change of interest rate was closely linked to fluctuation of price index. The margins or differentials between lending and borrowing rates maintained return for cost cover, tax, risk reserve and profit. Interest rates fluctuated as follows:

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<tr>
<td>Average Lending Rate</td>
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<td>2.9</td>
<td>1.9</td>
<td>1.4</td>
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(Source: State Bank of Vietnam)
Through development of the banking system and competition, the interest rate differentials were gradually reduced.

In the subsidy period, 90 percent of the bank credits were allocated for State owned enterprises, 10 percent for cooperatives and no credit for individuals. This showed that the SBV was the bank for state owned enterprises. During 1991-1995, the credit structure was changed fundamentally:

Table 3.2 Lending activities by years 1991-1995
(Percent)

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<tr>
<td>State owned Enterprises loans</td>
<td>81</td>
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<td>65</td>
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<td>Non-state Enterprises loans</td>
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<td>Total</td>
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</table>

(Source: State Bank of Vietnam)

In the past, the short term lending accounted for 95 percent of total lending balance, during 1990-1995, the rate improved remarkably as follows:

Table 3.3. Short, medium and long-term loans during 1990-1995
(Percent)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Short term loans</td>
<td>95</td>
<td>85</td>
<td>83</td>
<td>77</td>
<td>67</td>
<td>69</td>
</tr>
<tr>
<td>Medium term loans</td>
<td>5</td>
<td>2</td>
<td>4</td>
<td>14</td>
<td>18</td>
<td>24</td>
</tr>
<tr>
<td>Long term loans</td>
<td>13</td>
<td>13</td>
<td>9</td>
<td>15</td>
<td>7</td>
<td></td>
</tr>
</tbody>
</table>

(Source: State Bank of Vietnam)
Credit quality has also improved. Overdue loans were recovered significantly. In the past, it usually accounted for 15 to 20 percent, but in 1995, it was only 3.5 percent in the total lending balance. This was due primarily to autonomy and effectiveness of the State owned enterprises.

Many forms of fund raising with different terms were applicable. It varied from demand deposit to three months, six months, one year, two year, three year term deposits.

a) Savings in VND and foreign currencies;
b) Savings maintained the value by gold;
c) Commercial bank bonds in VND and in foreign currencies.
d) Commercial banking bonds;
e) Savings for housing development etc.

The deposit and saving interest rates were identified on market price plus 0.5 percent of real interest rate in a year to encourage people to deposit at the banks. The saving balance in 1986-1988 were about 2000 billion VND but at the end of 1995, the saving increased to about 17 000 billion VND.

The fund raising was for capital base increment both for lending operations and for adjustment of total payment instruments. Further, it sought to strengthen balance-of-payments, and inflation control. In the long run, it was preparatory work for short and long term capital markets.

The Policy for State Budget.

In the subsidy period before 1990, the SBV had to cover the state budget deficit but this was removed after 1993. The SBV and the Ministry of Finance are two government authorities; The Minister of Finance and the Governor of the SBV are two Cabinet members of the government. The Ministry of Finance is equipped with the function to manage the revenues and expenditures of the state budget; whereas, the SBV is manager of monetary system and controller of
monetary policy and operation. In term of state budget deficit, the state budget could earlier obtain borrowings from the bank but now the SBV did not issue bank notes to cover deficits of state budget.

The policy on foreign exchange control

Vietnam is always short of foreign currency that leads to serious balance-of-payment problems. Demand for foreign currency for the economy is always great, whereas, foreign currency inflow is very constrained. Vietnam’s focus on foreign exchange control is to exercise tight control over foreign currency outflow. It is also endeavored to expand and absorb optimally foreign currency into the country by adopting appropriate measures. Some of them are the following:

a) Encourage foreign direct investment.

b) Encourage Vietnam enterprises to use effectively the foreign loans (the government promulgated the decree No 58/CP dated 30 August 1993 on the issue). Government helps the enterprises, particularly SOEs to look for foreign lenders and provide quick disbursing assistance for strengthening SOEs effectiveness.

c) Expand money transfer services from foreign countries, and encourage the overseas Vietnamese to transfer money for helping families and relatives.

d) Control the gold reserves and precious stone market. The Vietnamese people used to store gold, whereas the bank had to pay in foreign currency for gold imported. In order to restrict gold import and save foreign currency, Vietnam encouraged foreigner and foreign institutions to move gold into Vietnam for processing and re-export.

e) On 4 August 1994, the Prime Minister promulgated the decision No 396/TTg regarding amendment of foreign exchange control in the new context. The decision was for the purpose of only domestic currency to be used in Vietnam, reducing foreign currency trading in the black market and strengthening the national foreign currency reserve through banking system.

In view with the foreign exchange control policy the following measures are taken:
i. Reduction in the number of the enterprises to open accounts in foreign currencies. The enterprises allowed to open foreign currency accounts were:

a. Commercial banks and financial companies;

b. The enterprises of the airlines, maritime and insurance sector that opened foreign deposit accounts for payments and collections at sight and clearing with customers;

c. The enterprises that obtained foreign investment capital, foreign currency account for foreign borrowings;

d. The Vietnamese economic units that were allowed to open their offices in foreign countries for their production and businesses.

ii. The enterprises were permitted to maintain a part of foreign currency on their accounts opened at domestic banks for their production and businesses. The remaining amount that was unnecessary for uses had to be sold either to the banks or financial companies.

iii. The percentage of foreign currency kept by the enterprises had to be agreed upon by the banks.

iv. The enterprises except commercial banks and financial companies licensed for foreign exchange operations were not allowed to provide loans make payments and fund transfer in foreign currencies with one another. All selling, buying and payments had to be done through the banks or the financial companies licensed for foreign exchange operations.

v. The domestic businesses and services only in domestic currency VND, except the duty free tax shops and the services at the airport, seaports licensed by the SBV.

vi. Set up foreign exchange counters in favorable places such as economic centers, big cities and wherever necessary to service customers in term of exchange of foreign currency into Vietnamese Dong (VND).

vii. Foreign currency in cash allowed to be taken out of the country without customs declaration was 7000 US$ since November 1994.

The promulgation of laws on foreign exchange control 396/TTg aimed at restriction of the balance of foreign currency of the enterprises that had earnings for the purpose of strengthening foreign exchange control. A great volume of foreign currencies was managed contributing to national foreign currency
reserves. Foreign currencies of the individuals were primarily not put under control due largely to its small amount.

The choice of macro instruments for monetary policy management appropriate to Vietnam conditions was one of the great issues as that required for a special consideration. In the initial years of monetary policy performance, the SBV could not bring into full play a series of measures like other developed countries. Vietnam adopted both direct and indirect instruments in the monetary policy management. Direct instruments were operated mainly through bank-by-bank credit ceilings, interest rates and exchange rates etc. and indirect instruments were for the purpose of supervising monetary policy, setting interest rates and managing the exchange rate in the short term capital market.

In order to strengthen interest rate as an effective instrument for managing monetary policy, the bank set interest rate from negative to positive. It was an important step in macro management of the banking system. However, the following issues required a special attention:

- Cover the gap between foreign currency interest rates and domestic currency interest rates. The gap was sometimes great in the past, which caused difficulties in inspecting and supervising the loans.

- Adjust the irregularity between long term and short term interest rates as long-term interest rates had to be higher than short-term interest rates.

- Shift SBV direct lending rates to discounting rates for commercial banks, which depend on the credit policy. In 1992, discounting rate was 70 percent, and it increased up to 80 percent, 85 percent and 90-95 percent in 1993, 1994 and 1995 respectively. This was for the purpose of a close inspection of the credit volume.

Actually, the exchange rate was not an instrument for monetary policy management. But the exchange rate was an important tool in stabilizing value of Dong, in Vietnam, its currency was not preferred in transactions due largely to its high denomination. The individuals and economic institutions were allowed to have foreign currency in any amount in transaction. Major foreign currency used in transactions was US Dollars. As the case, the exchange rate was not determined and managed properly; the investors could invest in foreign currency for profits, resulting in increasing the exchange rate and spontaneously devaluing the Vietnam Currency. The SBV intervention by selling or buying foreign currency would increase or reduce the volume of payment facilities.
During the centrally planned economy, the exchange rate was stable for years. The exchange rate of Dong (VND) were linked to Rouble of the USSR and it was used for international settlements (mainly between Vietnam and the Soviet Union and East European bloc).

At late 1980s and in the beginning of 1990s, the government maintained two exchange rate policies, namely the state official rate and the market one. The official rate was always lower than the market one. Now, the payments are not made in Rouble. USD is used for all payments. The existence of two exchange rates and the scarcity of hard foreign currencies led investors to invest in foreign currencies and increasing exchange rates. The management had no control over foreign currency reserves.

Setting exchange rate close to the market rate led to exchange rate control and increasing national foreign currency reserve. Together with the measures against inflation, strengthening VND value was a great concern of Vietnam authority. That could result in decreasing considerably the number of investors who invest in foreign currency and free float of exchange rates. It could be said that, since 1992, the exchange rate had been stabilized relatively. At the end of 1991, the exchange rate was at 14,000 VND or 15,000 VND per one USD. The SBV intervened in foreign exchange market and the rate was lowered down to about 10,500 VND per one USD. At the end of 1992, the rate was down again approximately to 9,000 VND per one USD. Low exchange rate resulted in difficulties for export. Again, the SBV had to intervene in the market and increase the rate to 10,500 VND for USD in 1993.

In order to identify the supply and demand of foreign currency and the market rate, the SBV established two foreign exchange centers in 1991, one in Hanoi and the other in Ho Chi Minh city. This was a step to set up foreign exchange market in Vietnam. In October 1994, the foreign exchange inter-bank market came into existence, replacing two former foreign exchange centers.

From 1992 to 1995, the Dong remained remarkably stable, fluctuating between 10,800 and 11,200 to US Dollar one. These developments helped in the promotion of exports and controlling inflation.

Compulsory reserve requirement

From 1991, compulsory reserve requirement was introduced as a main instrument for monetary policy management. According to banking decree law (banking ordinance), the percentage for compulsory reserve requirement
fluctuated between 10% and 35% of the total funds raised by the commercial banks. Vietnam then had smaller commercial banks and inflation was under control. So the SBV introduced 10 percent compulsory reserve requirement for the commercial banks.

The rate from 1991 to 1995 fluctuated around 10 percent. With the setting up of the deposit insurance company in 1996, the rate was fixed at 15%, but the commercial banks, particularly, joint stock banks could not fulfill compulsory reserve requirement. Their reserves were always around 10%. The steps were required for fulfillment of compulsory reserve requirement for commercial banks.

Table 3.4. Compulsory reserve requirement rates (Percent)

<table>
<thead>
<tr>
<th></th>
<th>Before June 1995</th>
<th>From June 1995</th>
<th>At the end 1995</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deposits</td>
<td>55</td>
<td>62.5</td>
<td>70</td>
</tr>
<tr>
<td>State treasury bond</td>
<td>15</td>
<td>7.5</td>
<td>0</td>
</tr>
<tr>
<td>Cash at bank</td>
<td>30</td>
<td>30</td>
<td>30</td>
</tr>
</tbody>
</table>

(Source: State Bank of Vietnam)

In 1995, the SBV has changed the structure of compulsory reserve requirement in conformity with inflation control and compulsory reserve requirements.

- One compulsory reserve requirement rate – 10% for demand deposits (Replaced the former ones: 13% for demand deposits and 8% for term deposits).

- In order to reduce the purchase of state treasury bonds and maintain liquidity. Higher compulsory reserve requirement could be introduced.

- Compulsory reserves were conducted twice, not once as in the past.

- Compulsory reserve was deposited in demand deposit account and maintained within compulsory reserve limit.
Rediscounting and discounting interest rates were important instruments for monetary volume management. In Vietnam, the application was simple way because commercial papers and drafts for SBV rediscounting were not available. In the initial stage of banking reform, the SBV had introduced the re-discounting method to commercial banks. The foundations for rediscounting were loan agreements – a legal document recorded a loan with a certain interest rate and a loan term between an enterprise with a commercial bank. When the commercial banks were unable to maintain its liquidity, they could take the loan agreements to the SBV for rediscounting. Through this facility, the SBV provided money to commercial banks for maintaining its liquidity.

Rediscounting interest rates were adjusted from low rate (70-80 percent) up to 100 percent; and upon necessity, the SBV could increase the interest rate over 100 percent for limiting credit expansion.

At the end of 1994, the following markets were gradually established in Vietnam as indirect instruments of the SBV to perform monetary policy and provide market signals:

- Deposit market;
- Domestic currency inter-bank market;
- Foreign currency inter-bank market;
- State treasury bond market.

Hence, the deposit market has improved. Many new forms of fund raising in order to create the medium and long term capital bases, such as Saving for housing development, commercial bank bonds etc. are evolved. The credit activities have developed both in the outstanding and lending services. At the end of 1995, the credit volume was 4-5 times greater. Not only lending activities but other banking operations were opened to service customers such as leasing, forfeiting, foreign exchange operations, stock exchange and investment consultancy, etc.

Domestic currency inter-bank market was to meet the credit capital demand among the commercial banks. By doing so, the SBV became the last lender in the process. More than 1000 billion VND were lent among the commercial banks. The foreign commercial banks and joint venture banks played an important role in the market as they provided substantial loans. Majority of
borrowers were state owned commercial banks. The lending amounts and the interest rates were based on the voluntary and negotiable basis.

The foreign currency inter-bank market, joint stock commercial banks, joint venture banks and foreign bank branches etc, even though newly established, they played an important role in helping to set up market exchange rate among commercial banks. This exchange rate was referred by the SBV for setting its daily official rate.

State treasury bond market opened 1994 worked in close proximity to the SBV. The SBV and the Ministry of Finance performed the auction of state treasury bonds periodically. The market was the foundation for evolving the “open market” in 2000.

The management and supervision of the banking system was organized in three following areas:

- Management and supervision of the SBV operations.
- Management, inspection and supervision of the credit institutions.
- The credit institutions’ self-management and control of their own operations.

According to the banking decree laws (banking ordinance), the SBV is an organ of the council of Ministers. SBV functions as state manager and controller on monetary, credit and banking operations in Vietnam. The management of the SBV is governed by a board of management whose members were appointed by the Chairman of the Council of Ministers. Besides the Board of Management of the SBV, there was a government supervisor appointed by the Chairman of the Council of Ministers.

The inspection of the organs and units belonging to the SBV was done through an internal inspection system headed by a SBV general inspector who was appointed by the governor of the SBV. The inspection system was responsible for operational check of all SBV organs and units for the benefit of the state. At each SBV branch, there were one or two inspectors under management of the chief inspector. The inspector unit was put under SBV general inspector.
The above internal inspection system focused only their operations on: cash management, security of treasury stores, financial expenses, accounting, real property and fixed asset. The inspection was not involved in appraisal and evaluation of the functions and duties of all SBV departments and divisions concern and in performance evaluation of the decrees, regulations and decisions issued by SBV governor. Up to present time, its performance has been to improve and inspect all internal operations of SBV system.

The management of credit institutions by the SBV was done through policies, mechanisms, and macro economic instruments. Coming along with issuing monetary, credit and foreign exchange policies etc, the SBV had promulgated and introduced numerous legal documents for monetary operations and management, creating the legal framework for monetary operations in the market economy.

The SBV has reorganized the banking supervision system. During 1988-1999, the banking supervision was very small, but after banking ordinance, the banking supervision system was expanded, continuously strengthened. Banking supervision system composed of general supervision department of the Central bank and supervision divisions of SBV branches. At the end of 1995, there were 500 inspectors in the banking supervision system. SBV supervision department with the network of SBV branch supervision divisions was a specialized institution of the SBV. Its performance was put under the state supervision and inspection system and SBV governor and included supervisory works to SBV branches, commercial banks and credit institutions. Banking supervision system was headed by a general inspector appointed by the chairman of the council of ministers at the request of the governor of the SBV and state general inspector.

Supervision divisions of SBV branches was headed by a chief inspecto appointed by the governor of the SBV at the recommendation of general inspector of the central bank.

The banking supervision and inspection witnessed changes during 1990-1995. The SBV has taken several steps to improve banking supervision and prudential regulations. Following the promulgation of the banking decree law on credit institutions, the SBV issued new regulations on the prudential ratio, on limits on lending to a single borrower, on limits on the use of short term funds for long term lending as well as on loan classification and provisioning. The SBV also issued regulations regarding the mergers, closures, and revocation of banking licenses for the joint stock banks. The SBV has also drafted regulations regarding off-site supervisory procedures. However, more works were required to be done, especially in loan classification and provisioning based on international accounting standards, and moving toward a risk based supervisory
approach. The SBV also strengthened supervision through by improving supervisory works, inspection training and internal audit of the credit institutions. They were advised to care for depositors and investors, safeguard public interest, and ensure compliance with laws, and regulations.

Nevertheless, many new aspects of banking inspection and supervision were yet to be evolved. Division of duties and responsibilities, the qualification of the inspectors, and sound personnel policies on recruitment, and fair salary scales etc. were to be formulated. The self-check and inspection of its own operations were promoted. Every credit institution had to establish its own internal inspection unit for inspecting all its operations.

The state owned commercial banks set up the internal inspection system consisting of internal inspection department at the headquarters and inspectors at the branch levels. Head of the inspection system was general inspector with the position as deputy general director. General inspector was appointed by the governor of the SBV at the proposal of the general director. At the large branches, there was inspection division put under the branch director. There were three to five inspectors in joint stock banks, who were on behalf of shareholders to inspect all banking operations and management in the period between two general shareholders meetings. Inspectors were elected with majority vote at general shareholders meeting. Among inspectors, there was a chief inspector elected by inspectors but he had to be approved by the SBV.

One of 4 major tasks of the banking sector in the renewal period\(^8\) is "renewal of banking technology and gradual modernization of banking operations". In 1990, for the first time, the SBV developed and realized a project which aimed at creating an advanced technical and infrastructure bases and modernizing banking technology in Vietnam. The project was entitled "Information technology (IT) Building and Development in the banking sector". This was a key point in the strategy for fundamental change in the Vietnam banking sector.

The project launched the principles for investment in IT application, identifying the steps, main applications for the purpose of equipping initial IT technical infrastructure. During 1990 to 1993, the projects gained many encouraging results. Vietnam developed an IT technical infrastructure as

\(^8\) 4 major tasks: - Complete monetary policy  
- Complete mechanism and instruments for banking management  
- Complete model for banking system organization and management  
- Renewal banking technology and gradual banking modernization.
presquisite for a strong change and modernization of banking technology to match the requirements of the banking system.

It equipped thousands of personal computers, moving manual staff into computer users, information technology application in the banking operation processes such as: accounting, payment, reporting and management.

After three years of project performance, another project - IT up graduation and modernization from 1994 to 2000 was approved. The automation of banking operations would be gradually performed with advanced technical solutions in conformity with international formalities and practices. In order to invest in technology, the government allowed each commercial bank to deduct 12% of its total fixed asset for IT project. Owing to this, the commercial banks could equip a considerable number of computers annually. Now, more than 90% of the banking operations have been done on computers and computer network. The computer in the banking system is used for data collection, analysis and back up. Personal computers run on MS-DOS and NETWARE, mini computer operated on UNIX, advanced language 4 GL. Application programs compiled by the banks could operate on their banking networks.

Vietnam has shown considerable progress in new technology application in terms of payments, particularly, the introduction of international cards such as VISA, MASTER, ANNEX, DINNERS and JCB etc. Turn over of card transactions was about 100 million USD in 1994. Expanding banking services among population, particularly, non-cash payments through personal checks, payment note, domestic cards etc. gained significant results. At the end of 1995, more than 38,000 personal accounts were opened at the banks and state treasury, with total deposit up to 700 billion VND, payments through personal accounts stood at thousands of billions.

Staff and employee training.

Based on reorganization of training system and training management, thousands of banking staff and employees were trained, particularly, addressed to the issues of banking knowledge in the market economy and banking technology. The following figures and data have shown the focus of the banking sector in the training area from 1991 to 1995:

<table>
<thead>
<tr>
<th>Category</th>
<th>Persons</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banking Education (graduate and post graduate)</td>
<td>23 139</td>
</tr>
<tr>
<td>Updating the knew knowledge on market economy</td>
<td>9 586</td>
</tr>
</tbody>
</table>
- Training under international sponsored programs
  (SIDA, WB, VIE...) 1756

- Short term study tours: thousands of staff have been sent abroad to all continents for study of the banking activities.

- In addition, thousands of the commercial bank staff were also retrained in the banking operations to cope with modern requirement.

Source: Personnel and organization Department, SBV

To respond to the requirement of the organizational structure under the direction of state management applicable to the SBV and applicable to the commercial banks, the banking sector has introduced new recruitment procedure and staff screening and selection so as to attract qualified staff to work.

The improvement of cooperative relations between Vietnam banking system with international financial monetary community have shown many positive impacts in tune with market economy. However, due to many special constraints, i.e. the collapse of the socialist system, the US embargo, and external debts came in the way for globalization.

The above situation can be divided into two periods: pre and post international donors forum for Vietnam held in Paris in October 1993.

In the pre-1993 period, Vietnam obtained a considerable aid from the former Soviet Union. This aid was cut in 1990 and the external debt remained great and any considerable aid from external sources was not coming. The relations between Vietnam with international financial and monetary institutions: WB, IMF were interrupted. After 1993, the relations between Vietnam and other western countries like Sweden, Japan, France, and Italy etc. were normalized, and limited official development aid was received by Vietnam. The embargo policy continued, but in the post-1993 period, the situation started changing. The western countries were particularly happy with the banking reform - a strong foundation for stable and sustainable development of Vietnam was envisaged. They believed that the re-establishment of cooperative and integrative relations between and international financial community was strongly required. The starting point for this period was the overdue loans payments. With the assistance of international donors, Vietnam has paid the overdue loans
to IMF. After this, IMF announced its full membership of Vietnam. Vietnam was immediately provided loan under special drawing right of the amount of 243 million $US. WB and ADB in succession also announced to provide loans for Vietnam. In November 1993, in Paris, WB and United Nations Development Program (UNDP) co-organized the first international donors forum for Vietnam. At this forum, the governments and international organizations committed to finance Vietnam 1 860 US$ million.

At the beginning 1994, the US economic embargo on Vietnam was lifted. In July 1995, the US government normalized the relations with Vietnam – the main barrier in the process of integration and cooperation was lifted. Hence the process of improvement of the relations between Vietnam with international financial institutions, foreign central banks, the foreign bank branches operating in Vietnam and joint venture banks and between Vietnam commercial banks with foreign banks were witnessed.

The former government of South Vietnam had joined International Monetary Fund and World Bank in 1956 and had been member of Asian Development Bank since 1966. Financial contribution in three international financial institutions were as follows:

<table>
<thead>
<tr>
<th>Institution</th>
<th>Total financial contribution ($US million)</th>
<th>Financial contribution in gold and foreign currency ($US million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. IMF</td>
<td>62 million SDR</td>
<td>442 857 271 ounce gold</td>
</tr>
<tr>
<td>2. WB</td>
<td></td>
<td></td>
</tr>
<tr>
<td>-IBRD</td>
<td>54.3</td>
<td>552 492</td>
</tr>
<tr>
<td>-IDA</td>
<td>1.616</td>
<td>151 000</td>
</tr>
<tr>
<td>-IFC</td>
<td>0.166</td>
<td>166 000</td>
</tr>
<tr>
<td>3. ADB</td>
<td>36.2</td>
<td>4 158 095</td>
</tr>
</tbody>
</table>

Note: IBRD – International Bank for Reconstruction and Development
IDA - International Development Association
IFC - International Financial Corporation.

Since its participation in these international financial institutions till 1975, South Vietnam could not obtain any loans from IMF and WB. Only ADB signed loan agreements for financing nine projects with total amount of 44.4 million $US, but only 4.6 million $US was withdrawn.
During 1977-1993, IMF provided loans merely of 71.54 Special drawing
rights (SDR) to Vietnam, of which 28.4 was credit facilities and 43.14 SDR
under trust fund. From 3 December, 1984, the Board of Directors of the Fund
decided to abolish the right to use reserve fund to Vietnam. Since then, the
relation between The Fund and Vietnam was only in some technical assistance
programs, staff enhancement, consultancy services in formulating monetary and
financial policies.

At the end of 1990, the Fund recognized the achievements that Vietnam
made in the successful implementation of the renewal policy, the relations
between the Fund and Vietnam improved. The Fund set up permanent
representative office in Vietnam. However, the US unwillingness restrained
relations between Vietnam and the IMF.

The IMF and Vietnam signed one year economic program in 1993 under
standby facilities for 243 million $US. Vietnam has withdrawn 192.8 million
$US, the rest was agreed by the IMF to credit in economic structural adjustment
facilities (ESAF). In November 1994, The IMF continued to provide facilities
under ESAF three year program (1994-1997) with the amount of 362.4 million
SDR corresponding to 535 million $US. This facility was semi annual drawing,
dependant upon the policy implementation.

During 2 years 1993-1994, The total loans drawn by Vietnam from the IMF
was 281.4 million $US. Apart from providing loans, The IMF also sent many
experts and consultants to assist Vietnam in organizing forums, workshops and
training programs in order to catching market mechanism and joining financial
monetary community.

World Bank provided Vietnam a loan of 60 million $US in August 1978
from funding source of international development Agency (IDA) together with
30 million $US provided by the Netherlands, Kuwait and agricultural
development fund (ADF) under co-financing – each party, 10 million $US. The
loan was used for Dau Tieng irrigation project with preferred interest rate of
0.75% per annum and the term loan was 10 years. But relations were interrupted
after Cambodia crisis in 1978. It started improving after 1993. The WB sent
many expert groups to Vietnam to study monetary and financial environment.
The WB together with IMF and UNDP assisted Vietnam in organizing the
financial system and with Swedish International Development Agency (SIDA)
which financed the staff training project in co financing State owned enterprises
reform with UNDP.
Relation between Vietnam and the WB has been improving significantly. In 1993, they signed 2 loan agreements, one for primary education project and the other for upgrading the highway No 1A with the total amount of 228.5 million $US. But disbursement was slow due to the fact that Vietnam did not have sufficient infrastructure for implementation.

In 1994, WB agreed to sign two more loan agreements, one for agricultural recovery and structural adjustment program with the total amount of 246 million $US. In 1994, WB signed agreements for four projects with the total loan of 474.5 million USD. This was for Structural adjustment facility, Banking system modernization, irrigation network recovery and electricity network upgrading.

On the other hand, the relation between Vietnam with ADB also started improving. In January 1977, ADB had provided for nine project loans with the amount of 44.6 million $US and technical assistance of 1.1 million $US but it was also halted after 1978. The relations started improving after 1992. ADB sent many delegation to Vietnam for economic survey, the project loans and technical assistance. ADB made many proposals and recommendations to Vietnam on macro-economic adjustment and management, particularly, agricultural development policy.

In 1993, the two sides signed a loan agreement for anti-flood and irrigation system recovery project with the total amount of 73.6 million $US. In 1994, there were 2 more projects financed by the banks: Ho Chi Minh city water supply project and Highway 1A upgrading project (from Nha-Trang to Ho-Chi-Minh city) with the amount of 185 million $US. During two years 1993 and 1994, the bank provided loans to Vietnam of 258.6 million $US.

The relations with foreign central banks were also expanded significantly. In 1992 and 1993 respectively, the SBV negotiated and signed loan agreements with Taiwan and Switzerland with an amount of 57.5 million $US and low interest rate for financing the small and medium scale enterprises in Hanoi, constructing the highway No 5 and some other key government projects. The SBV in joint efforts with the ministry of dykes and irrigation signed loan agreements with Kuwait to construct Yazun damp project in central highland of Vietnam. The SBV also negotiated with central banks of Malaysia and China to sign bilateral payment agreements and in succession, SBV signed financial agreements with central banks of France, Thailand and Italy. etc. for technical assistance, staff training, exchange programs, workshops and study tours etc.

The SBV together with Central Bank of France and several other Central Banks and International Monetary Fund (IMF) promoted the establishment of
supporting group fund raising of an amount 140 million $US to pay back IMF. This supporting group was set up in December 1993 after Vietnam and IMF had signed the agreement on the economic program. With this bridging fund, Vietnam could pay back definitely the loan amount to IMF and normalized the relation with this financial institution. Immediately, IMF provided loans to Vietnam and since then the official aid channels have been opened. In November 1993, some donors forums were held in Paris and committed an amount of 1.86 billion $US at the end of 1993.

The efforts made by the SBV in expanding relations have created favorable conditions for international financial community to have better understanding of the achievements gained in Vietnam. The achievements gained in implementation of reforms for creating a sound banking system. Vietnam has been ready to expand its relations with foreign banks in the future. Many senior banking groups have been sent to those countries for exchange programs, survey and study at their banks.

Many foreign central banks have provided Vietnam central bank technical assistance programs, and received many groups of Vietnam commercial banks to research and study in their exchange programs. The research and study covered particular areas of banking operations such as capital management and fund use, securities market, foreign exchange market, banking supervision, credit cards, electronic banking and home banking etc. Nearly ten years ago, The SBV paved the way for official development aid (ODA) channel to Vietnam with greater disbursement.

The meeting of International forum of Donors to Vietnam, held in Paris in 1994 committed an amount of 3.2 billion $US to Vietnam, in which, Japan committed to finance 1.216 million $US, the WB 900 million $US, ADB 532.5 million $US, France 1.0119 million $US, Great Britain 95.3 million $US, European community 67.2 million $US, Sweden 59.2 million $US, South Korea 45.5 million $US, Australia 38.4 million $US, Denmark 16.8 million $US. In 1995, official development aid was approximately 500 to 600 million $US.

The reforms in the banking laws in 1991 endeavored to create favorable conditions for foreign investors to transfer funds into Vietnam. It created opportunities for obtaining all funding sources on the international market through foreign bank branches or joint venture banks to invest. It was projected that presence of the foreign banks in Vietnam would help the modernization process of the domestic banks and get access to the advanced banking technology, and upgrading the qualification of the banking managers.
The SBV till 1995 has licensed 19 foreign banks to open their branches in Vietnam. Majority of them were based in Asia and the Pacific. The following banks were granted licenses to open branches for operation in Vietnam:

- 4 French Banks: Credit Lyonnais, Banque National de Paris (BNP), Indosuez and Banque Francaise pour le commerce Exterieur (BFCE)
- 2 Thailand banks: Bangkok Bank and Thai Military Bank
- 1 Australian bank: ANZ Bank
- 1 Taiwan bank: Chinfion Bank
- 1 Singapore bank: United Oversea Bank
- 1 British bank: Standard Chartered Bank
- 1 Chinese bank: Bank of China
- 2 banks of the Netherlands: International Nederlanden Group (ING), ABN AMRO Bank
- 2 American banks: Bank of America and City Bank
- 1 Hong Kong bank: Hong Kong Bank
- 1 German bank: Deutsch Bank
- 1 Malaysia bank: May bank
- 2 Japanese Banks: Fusitsu Bank and Bank of Tokyo & Mitsubishi,

Besides, there are four joint venture banks, including:

i. Indovina bank – joint venture between Dagang National bank of Indonesia with Vietnam Industrial and commercial bank (VIETINCOMBANK)

ii. VID Public Bank – joint venture between First Korea Bank of Republic of Korea with Vietnam bank for investment and Development (BIDV)

iii. First Vina bank: joint venture between Korea First Bank of Korea with Bank for foreign trade of Vietnam (INCOMBANK)

iv. Vinasiam bank – joint venture between Thailand Siam Bank of Thailand with Vietnam Bank for Agriculture and Rural Development (BARV)

Majority of foreign banks and joint venture banks developed quickly. They started marketing research, creating customer bases, fund raising and settlement operations. Their operations in general were stable and profitable.

The presence of foreign banks in Vietnam initially created the confidence among foreign investors, creating many opportunities for foreign enterprises to expand their trading and investment activities in Vietnam. Foreign banks
provided active consultancy services to foreign customers that contributed a lot to the advertisement and introduction of Vietnam healthy environment to foreign investors. It enabled diversification of banking products and services in Vietnam and created more dynamic forces for Vietnamese financial market, that is new competitive position in the monetary market and contributing to internationalization of Vietnam banking system.

Technical assistances under the forms of consultancy and training were also provided by the foreign banks to domestic commercial banks and to young banking staff groups to take advantage of the banking operations in the market economy, of globalization and liberalization. The main problem was fund raising and capital market of the foreign banks. Direct borrowing from international capital market for re-lending in Vietnam was very limited.

Regionalisation and globalization are prevailing norms in the world today. The nations depend more with one another on the international market with boosting the cross border trades that expand international market of products and services. Indeed, the international financial market is also expanded. The international financial institutions such as World Bank (WB), International Monetary Fund (IMF), and the regional financial institution like Asian Development Bank (ADB), and the international financial centers based in Switzerland, Japan, Germany, Hong Kong and Singapore have come into being for long and more financial centers will be established in the future.

In order to expand their operations internationally, the banks often develop their banking networks, looking for cross border customers by using advantageous and specialized technology and competing fiercely. The main trends that the banks exploit for international competitions are as follows:

- International business strategy;
- Developing customer policies, creating advantages for customers;
- Advanced technology development (IT and e-commerce);
- Organizational development (international network);
- Capital increase (maintaining liquidity).

The major risks and exposures that the banks always cope with are:
- Interest rate risk; (fluctuations of exchange rates);
- Foreign and foreign exchange exposure (float of exchange rates);
- System risk (sound and healthy system or not);
- Environmental risk (environmental impact);
- Mechanism risk (mechanism changes).

Many risks not only come from a single bank but also from many other banks and from fluctuations in the socio-economic situation of the regional or global level. The concurrences can make a bank or a banking system collapse or bankrupt. Initial impacts are with interest, exchange, and inflation rates.

In order to escape from risks and exposures, it requires that the banks themselves establish their own reserve funds and preventive actions. The reserve funds can be allocated from the banks' revenues.

In the context of developing market economy under socialist orientation in Vietnam, the central bank – the SBV must be organized and managed under uniform rules. Lenin has pointed out in his discussion on banking policy: "Banking policy must be gradually introduced and operated through the banks - uniform organizations to perform accounting function and adjust economic life to be organized under socialist form for the whole country." 9

The scientific and technological revolution in which information technology (IT) continue to develop at a high level, have created the dynamic forces for nations' development and growth. The international context is favorable to Vietnam, but challenge of restoring higher growth and employment to sustain rapid reduction in poverty, remains. The regional crisis is abating, exports are recovering and macroeconomic performance is good. But private investor confidence remains weak and domestic demand continues to falter. Severe floods in the central region have imposed additional costs. Overall economic growth is estimated 6% in 2002, but mainly because of stronger agricultural performance. Non-agricultural growth continues to slide. With per capita GDP growth lower than a third of the rate of earlier years, sustaining earlier rates of poverty reduction or of employment generation will not be possible unless higher employment-creating growth is promoted.

9 V.I.Lenin whole works – Vietnamese, the progress publishing house, Moscow 1976, Vol 36, p 270.
In term of economy, the coming years are very important to achieve the targets. Average GDP per capita is doubled in comparison with 1990, average annual GDP growth is about 10%. Investment rate of GDP is approximately 30%, and the share of GDP by the sectors: agriculture 25%, industry and services 75%.

In order to achieve the target of industrialization and modernization of the country, Vietnam requires great volume of capital. The capital sources are both domestic and external. The domestic sources are decisive and external sources are important. Developing the capital base requires national financial system to do best efforts. The banking system with strong banks are the main forces in creating capital resources. V.I.Lenin highly emphasized the role of the banks "Absence of large banks, the socialism can not be implemented" and he considered the banking system as "the backbone of socialism".

Creating capital base for industrialization and modernization of the country is one of measures to develop Vietnam to quickly join regional and international community. So overall renovation of the banking sector from planning, policy instruments, performances, operations, marketing and customer services can meet the requirement.

Reforms as the base for banking modernization

Production modes are changing under the new dimension based on high technology. This process is changing production modes, scales, product quality and investment rate. Particularly, information technology (IT) is increasingly used to change quality on every social requirements.

The banks requirement is to accelerate their modernization process, if not, they will loose customer base. Traditional banking with transactions at the counters, cash tellers, banking transactions today are on line system, wherever it can, the bank notes are replaced by electronic money and plastic money. Banking services connect enterprises, investors together on the global scale. Every fund transfer of great value (billions of currency) can be transacted in

10 V.I.Lenin whole works – Vietnamese, the progress publishing house, Moscow 1976, Vol 36, p 404-405.

11 V.I.Lenin whole works – Vietnamese, the progress publishing house, Moscow 1976, Vol 34, p 404-405.
The appearance of foreign banks in Vietnam with great capital potentiality, advanced technology, and qualified staff, that made them as strong competitors to the domestic banks. This is a dynamic force to accelerate the renovation process, development for mergers of the domestic banks.

Advanced financial services are gradually imported into Vietnam, creating advantages for these banks, and offering challenges to other banks in turn. The banks must race in the long run for maximal benefits to their customers in terms of capital, payment services, customer culture including preferred interest rates.

The Government's objectives for this second round of reform - to develop a safe, sound and comprehensive banking system that will help protect macroeconomic stability, instill financial discipline effectively i.e. more saving mobilize more savings and allocate them to more efficient uses - are very appropriate. Also government's overall reform approach - developing a comprehensive program, relying on market-based instruments if implemented. That sounds reasonable. At the same time, an integrated program will be established, based on market instruments12 and implementing state owned enterprises reform at the same time.

The Government of Vietnam began this round of banking reform with the approval of two banking laws in November 1997 and formation of the bank restructuring committee (BRC) in April 1998. Since then, the BRC has developed a five-track banking reform program. They are the following:

12 At the end of 1997, Vietnam's banking system consisted of four state owned commercial banks (accounting for 82 percent of total bank assets), 51 joint stock banks, whose shareholders include state owned enterprises and private entities (accounting for 10 percent of total assets), and 23 branches of foreign banks and four joint venture banks (together accounting for 8 percent of total assets). Total bank assets were 38 percent of GDP, total loans, 22 percent and total deposits, 20 percent, indicating relatively low degree of monetization of Vietnam's economy. Country experiences show that a particularly costly alternative in terms of long-term growth is the recourse to non-market instruments of bank restructuring-interest and exchange controls, strengthening of state banking and directed lending to priority sectors, limiting competition, and restricting the scope of banking activities.
- Restructuring Commercial Joint Stock Banks (JSBs)
- Restructuring State Owned Commercial banks (SOCBs)
- Improving regulatory, supervisory and legal framework
- Leveling the playing fields for all banks, and
- Developing Human capacity and resources in the banking sector.

The Government started with diagnosing the nature and extent of banking problems in the State owned commercial banks and joint stock commercial banks. Independent diagnostic audits of the four state owned commercial banks and the SBV assessment of the 51 joint stock banks found that non performing loans (NPLs) in both the state owned commercial banks and joint stock banks were substantially higher than those estimated earlier. On the basis of this diagnosis, the government rightly decided to deal with the restructuring of joint stock banks in Ho Chi Minh city as first priority together with improvements in prudential regulations. Restructuring the other joint stock banks and four large state owned commercial banks as well as leveling of the playing field for all banks were to follow. This is because joint stock banks in Ho Chi Minh city were found to be most vulnerable segment of the banking sector, given their level of distress and the fact that Ho Chi Minh city was the most important business center. The SBV assessment of 51 JSBs was completed in March, 1999 and independent diagnostic audits of the four SOCBs were reported in February.

13 JSBs accounted for more than 25 percent of banking sector assets in that city and the city itself accounted for a quarter of Vietnam GDP, two fifth of foreign investment inflows, and over half of the country's export. Together with foreign bank branches in Ho Chi Minh city, JSBs account for 60 percent of total lending in the city.
Box 3.1. Banking Reforms in 1999

The following measures were taken:

- Completed financial assessment by SBV of all 51 JSBs (Mar) and independent diagnostic audits of 4 large SOCBs by international consultants (Feb).

- Developed a preliminary action plans for restructuring all 51 JSBs and operational restructuring strategy for SOCBs (Mar).

- Issued regulations on "special control" regime including revoking the licenses of troubled banks and "special supervision" regime which strengthens supervisory oversight (Apr).

- Closed 4 JSBs in Ho Chi Minh city, placed another 6 JSBs under SBV's "special control" regime and merged 2 JSBs (by Nov).

- Initiated development of a legal framework for removing non-commercial lending activities from state owned commercial banks: Submitted to the government a plan to live off Bank for the poor as a Policy Bank to lend to socially targeted groups (Jun) and issued a decree on establishment of a "Development Support Fund" to be funded by the budget to provide loan guarantees and interest subsidies for strategic purposes (Jul).

- Issued several prudential regulations for banking operations, namely, Assets classification, and loan-loss provisioning; financial ratio for safe operations of credit institutions; organization and authority of banking inspectors, and deposit insurance and collateral regulations (Sept)
Restructuring Banking System

Restructuring JSBs, especially those in progress, the financial health of 51 JCBs were assessed and steps were taken to address the most problems. Based on triggers that included measures of insolvency, illiquidity, and losses relative to capital, the SBV intervened in several JSBs under two different regimes, under which teams from the SBV took over all aspects of bank operations and management. Second, there was a "special supervision regime", under which prudential oversight was strengthened in day-to-day operations of JSBs but under closer supervision of SBV. As of December 1999 the following actions have been taken:

- Several joint stock banks were put under "special control"
- Four joint stock banks closed, including Viet Hoa, Nam Do, Dong A, Chau A Thai Binh Duong Banks.
- Two joint stock banks merged, including Ho chi Minh City housing Bank and EXIM Bank.
- Several joint stock banks under "special supervision"

Restructuring state owned commercial banks is still in its early stage. International audits of four large state owned commercial banks were completed in early 1999. The major weaknesses of the state owned commercial banks were identified in international audits and in SBV's own assessments. Governance problems and problems weaknesses were found to be common. Accounting practices made credit-evaluation problematic. In SOCBs the legacy and the culture of the “mono bank” system had not encouraged managers to actively pursue the basic objectives of bankers in market economies. "Their Frozen loans" (inherited from mono bank system) were cleared in the recapitalization exercise of October 1998. The problem cited in general strategy for the SOCBS sector developed by SBV was the following: high risk profile of the banks' asset portfolios, low profitability, heavy reliance on lending activities, inadequate internal controls and poor information management.

Based on these assessments, at the beginning 1999, The SBV asked each state owned commercial banks to develop a restructuring plan aimed at
improving the competitiveness of SOCBs, strengthening the internal operations and management, and integrating them with international financial system. These plans would cover structural and operational actions including the following:

- Increase autonomy in formulation of business plan and distribution of revenues;
- Establish independent committees for internal control and supervision;
- Cease policy lending by SOCBs;
- Develop and implement plans for addressing existing stock of Non performing loans;
- Design strategy for streamlining management operations and operational staff;
- Improve management information systems and accounting standards, to comply with international accounting criteria; and
- Improve management development and staff training.

The SBV has taken several steps to improve banking supervision and prudential regulations. Following the promulgation of the law on credit institutions, the SBV has issued new regulations on prudential ratio, on limits on lending to a single borrower, on limits on the use of short term funds for long term lending as well as on loan classifications and provisioning. The latter marks an improvement in terms of clearer standards for loan classification and provisioning. However, this regulation unfortunately does not classify the whole value of the loan as overdue when any part of principal or interest is overdue. The SBV also issued the regulations regarding mergers, closures and revocation of banking licenses for the joint stock commercial banks. The SBV also drafted regulations regarding off site supervisory procedures. However, more works needs to be done, especially in loan classification and provisioning based on international accounting standards, and moving toward a risk based supervisory approach.

There is also a need to enhance analytical and technical capacity of supervisors so that they can better analyze the financial information of the banks they supervise as well as the credit information of banks’ borrowers. Also accounting standards need to be upgraded to international accounting and auditing standards.
The agenda for banking reform over the next three to five years will cover mainly the restructuring of the state owned commercial banks and Joint stock commercial banks, the development of the regulatory, supervisory and legal framework and creation of a level playing fields for all banks.

On restructuring both state owned commercial banks and joint stock commercial banks, the authorities are planning to establish an asset management company (AMC) focusing on non-recoverable debts that have collateral. The AMC would be funded mostly by the government and would buy and sell the bank loans secured by the collateral that the bank could not liquidate because of the nature of the assets, lack of documents or origin of the loans. Although auction mechanisms have been piloted to sell foreclosed collateral, it has been a slow process. And it is likely to remain a slow process in future if the enabling legal environment and the functioning of real estate market are not improved.

The goal for JSB restructuring is to reduce the number of JSBs by nearly half by closing, merging and consolidating existing JSBs. Bank-by-bank restructuring plans for JSBs emphasize operational reforms, debt workouts, and re-capitalization (including through an increase in the foreign ownership limit of bank capital). Public funds would be used sparingly for their re-capitalization and under appropriate conditions. Separately, a decree providing a limited deposit protection scheme aimed at small depositors has been issued, and the framework to guide JSBs own restructuring is being issued in phases.

On the SOCB restructuring, the main challenge is to reform them into commercially oriented and viable banks, in particular, by preventing the recurrence of high levels of NPLs and creating a market-oriented credit culture in their management. For this purpose, actions to address the existing stock of NPLs and to strengthen bank management are key issues. Each SOCB would have to develop a detailed restructuring action plan, covering the critical components. It is projected that 30 000 billion VND equivalent to 2.1 billion USD will be required by the Vietnam banking system over next five years for restructuring domestic commercial banks of which approximately 7000 billion VND will be used for resolving SOE non performing loans. Although greater volume would be, but banking reform must be undertaken for the purpose of absorbing the investment capital, aimed at annual economic growth rate of 7.2% over next ten years.

14 Asia Pulse Via Comtex, Hanoi 14 June 2001.
### Box. 3.2. Developing Healthy Banking System: A three-year Agenda

**Restructuring the state owned commercial banks and joint stock commercial banks.**

- Create a sound and transparent mechanism for resolution of failed/troubled financial institutions.
- Implement and enforce regulatory framework for all 51 joint stock commercial banks and complete action plans for all commercial joint stock banks in phases.
- Establish an asset management company (AMC).
- Agree on key elements of the restructuring plans between Government and state owned commercial banks that involve strengthening management, resolving non-performing loans and developing phased re-capitalization.
- Complete restructuring plan for each state owned commercial bank and develop an implementation timetable.
- Equitize one of four state owned commercial banks by the end of 2002.
- Remove non-commercial lending by state owned commercial banks except in special circumstances where there is an explicit government guarantee.
- Adopt the international definition for classifying NPLs, where if any installment of a loan is overdue, the total value of that loan is classified as NPL.
- Adopt regulations that prohibit banks and financial institutions from lending to shareholders and directors including persons or entities related to them.
- Move towards a risk-based approach to bank supervision.
- Develop a detailed plan to upgrade accounting standards and systems for banks and borrowers to international standards.
- Initiate training programs for banking staff in credit risk management.
- Relax restrictions on doing deposit mobilization by foreign banks.
- Ensure that all state owned commercial banks have no preferential treatment relative to joint stock commercial banks.
The banking system and financial institutions would emphasize on restructuring their own organizations and improving technical infrastructure bases. The funds used for banking reform over next five years will be taken from commercial banks, non-transferable government treasury bills and official development aid (ODA). The central bank has also proposed to the government for removing non-commercial lending by SOCBs except in special circumstances where there is an explicit government guarantee. The success of the banking reform relies much on the restructuring of 6000 State owned enterprises through mergers and liquidations and receiving more than half of all credit through the formal banking system, while generating less than 10 percent of employment.

The SBV would strengthen the credit risk fund and establish an asset management company (AMC) focusing on non-recoverable debts that have collateral. The AMC funded mostly by the government, and was to buy and sell bank loans of about 5 billion US$\textsuperscript{15} of which the share of foreign banks accounted for 13.7% that the banks could not liquidate. Increasing aid in capital of a commercial bank from 70 million US$ to 200\textsuperscript{16} million US$ is also being considered to strengthen bank capital base.

\textsuperscript{15} SBV report of Non performing loans (NPLs), 2000
\textsuperscript{16} SBV’s plan of actions, 2000