Master's Thesis

A Study on Vietnam Banking Restructuring:

Comparison between before and after 2011

베트남 은행개혁에 관한 연구:

2011년 이전과 이후의 비교

August 2014

서울대학교 국제대학원

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A thesis presented

by

Le Thu Huong

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Graduate School of International Studies

Seoul National University

Seoul, Republic of Korea

August 2014

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Thesis Advisor Prof. Yeongseop Rhee

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Comparison between before and after 2011

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July, 2014

ABSTRACT

A Study on Vietnam Banking Restructuring:

Comparison between before and after 2011

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The banking sector is always an important part of any economy. Therefore, it is necessary for every country to develop and maintain a good banking sector to support not only the economy but also the society. After more than two decades of experiencing the rapid growth, Vietnamese economy in general and banking sector in particular has been facing problems: high inflation and declining growth rate, boom and bust in real estate sector, high inefficiency in state investment and state-owned economic groups, growing bad debts and banking instability, high interest rate and massive bankruptcy in private sector. As a respond to urgency of this matter, the Vietnamese government announced a program for banking restructuring called Decision 254 in 2011.

This study gives the background of Vietnam Banking sector, the current problems the sector has been facing. It then analyzes the banking restructuring progress after Government's Decision no. 254 was adopted and compares efforts and results of this new restructuring program with previous ones on Vietnam banking reform and restructuring.

Keywords

Vietnam, Banking system, Decision no.254, Banking Restructuring, NPLs
Student ID: 2012-22813

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LIST OF ABBREVIATIONS AND ACRONYMS

ACB	Asia Commercial Bank
ADB	Asian Development Bank
BIDV	Bank for Investment and Development of Vietnam
CC	Credit Cooperatives
CCF	Central Credit Fund
FB	Foreign Bank
FBB	Foreign Bank Branch
IMF	International Monetary Fund
JSCB	Joint Stock Commercial Bank
JVB	Joint Venture Bank
LCF	Local Credit Fund
NPL	Non-performing Loan
PCF	People's Credit Fund
RCF	Regional Credit Fund
SOCB	State – Owned Commercial Bank
SOE	State - Owned Enterprise
SBV	State Bank of Vietnam
Techcombank	Vietnam Technological and Commercial Joint Stock Bank
Vietin Bank	Vietnam Joint Stock Commercial Bank for Industry and Trade
VBARD	Vietnam Bank for Agriculture and Rural Development
VCB	Joint Stock Commercial Bank for Foreign Trade of Vietnam
WTO	World Trade Organization

I. INTRODUCTION

1. 1 Brief Introduction

The banking sector can be considered the “blood vessel” for the whole economy. A developed and healthy banking sector of the country ensures to attain a sustainable development for that country. Therefore, it is necessary for any country to develop and maintain a good banking sector to support not only the economy but also the society.

Vietnam, a nation ravaged by wars, has emerged as one of Asia’s great success stories. The country has transformed from a centrally planned to a market economy since the open-door economic policy (Doi Moi Policy), which started in 1986, and the policy to attract foreign investment, endorsed by the Sixth Congress of the Communist Party of Vietnam. Along with the transformation of the economy, Vietnam banking system has gone through substantial changes and reforms, contributing an important part to the socio-economic development of the country.

Over mostly thirty years of banking revolution, Vietnam banking system experienced a banking boom in terms of the number of banks, banking services and total assets and achieved initial successes. However, besides remarkable achievements, the banking system also revealed weaknesses and have been facing serious problems. Especially, in the context of WTO accession in 2006, increasing international economic integration and after financial crisis and global economic downturn, it is necessary for Vietnam to restructure again not only its economy but also the banking system which is a key factor to ensure a sustainable development. It is imperative for the Government of Vietnam to

adopt an effective banking sector restructuring program to prevent banks from insolvency and restore the health of the banking system in order to boost economic recovery. Recognizing the urgency of this matter, the 11th Central Committee of the Communist Party of Vietnam (2011) has instructed the Government to restructure the banking and financial institution system. Therefore, the "Restructuring Financial Institutions 2011-2015" program (Decision no.254/QD-TTg dated March 1st 2011) was adopted.

Since Economic Reform procedure (1986), Vietnam banking system has been restructured/ reformed many times with different contents and forms over the past decades and banking reform is a complicated, controversial and sensitive issue which has been debated for years. Although this is not the first time Vietnam has restructured/reformed the banking system, this reform is the most recent one and it has different background, objective as well as different results. It is considered gaining initial successes in restructuring Vietnamese banking system, helping banks achieve safe operation and stable performance to be more competitive and consistent with international standards. In this thesis, the research focus mostly on the problems Vietnam banking system has been facing in recent years, analyzing the banking restructuring progress after Government's Decision no. 254 was adopted and comparing efforts and results of this new restructuring program with previous ones on Vietnam banking reform and restructuring.

1.2. Research Objectives

When this study was started, bank restructuring in Vietnam is imperative issue so it is the right time to discuss about banking restructuring in Vietnam.

Thus, the major objectives of the thesis are: (1) to obtain the background of Vietnam Banking sector, the current problems Vietnam sector has been facing; (2) to gain a better understanding of previous banking reform/ restructuring in Vietnam and new banking restructure program adopted by Vietnam government (Decision no.254); (3) to compare this recent reform with the previous efforts before 2011.

1.3. Research Methodology

This research uses qualitative research method, including comparison analysis, secondary data collection from financial statements, annual reports of commercial banks, the State Bank of Vietnam (SBV), and related reports of other organizations such as International Monetary Fund (IMF), and the Asian Development Bank (ADB) as well as statistic data sources of other research institutions.

1.4. Limitation

At the time of writing this research, the restructuring in Vietnam 2011-2015 is far from completion and the resource of references is limited due to banks' data security and secrecy. Therefore, this thesis cannot provide a totally accurate picture about Vietnamese banks' situation. However, this study will focus on the comparison of background, objectives, results as well as limitation of reform phrases in Vietnamese banking system.

Another limitation is lack of accurate statistics due to the political reasons (differences between the government report and other research institutions and the information is usually not accurate) as well as the difference between Vietnamese accounting measure and international accounting measure.

Therefore, the statistics that are nearest to foreign reports will be used.

1.5. Thesis Structure

This thesis includes 7 main parts. Part 1 will give readers a general understanding of this thesis's content, the reason of choosing this topic. The next part will review previous research regarding banking restructuring and banking restructuring in Vietnam. In part 3, a general overview of Vietnam banking system traced from history of formation, structure and main characteristics of the banking system will be provided. Part 4 will help readers gain a better understanding of previous efforts on banking reform and restructuring in Vietnam before 2011. The current problems of Vietnam banking system will be introduced in part 5 and at the same time, policy directions and progress of banking restructuring program in Vietnam after 2011 will be also analyzed. The comparison between banking reform phrases in Vietnamese banking sector will be dicussed in the part 6. The final one is part 7 and it will be a summary of this thesis.

II. LITERATURE REVIEW

2.1 Literature review on Banking Restructuring

There is a number of extensive studies on restructuring and reform of the banking system around the world. Most studies have implied that the banking system restructuring has profound effects on the national economies.

What is bank restructuring?

According to the International Monetary Fund (IMF, 1999), there are three goals for countries to restructure the banking system: (1) to strengthen the operational efficiency of the banking system through ensuring solvency and profitability, (2) to improve the capacity of financial intermediation function of the banking system between the borrower and the lender, and (3) to recover public confidence. This study also differentiates restructuring the banking system from restructuring individual banks. The bank system restructuring consists of a series of measures to ensure the national payment system and access to credit resources in the process of rectifying weaknesses in the financial system due to crisis or emerging from crisis.

Meanwhile, in the study of Waxman (1998), the bank restructuring is mentioned as a solution of a failed bank within an effectively operating banking system. Restructuring individual banks is closely related to the restructuring of the whole banking system when they are particularly large in terms of scale. The study also proves that the collapse of one or more big banks may affect over 20% of the total deposits of the banking system so in this case banking system restructuring is to deal with these banks to ensure the stability of the whole banking system.

The subject of restructuring is the difference between these two above approaches. If the Waxman's viewpoint is explained based on the large banks, the IMF viewpoint aims at the entire banking system. However, both of two viewpoints have one thing in common is that they aim at the banking system in the deficient economies in developing countries which are integrated and transformed, where the banking system is dominated by a few large banks (also with less efficient operation) and large shocks in the banking system can lead to the collapse of the economy.

When to restructure?

It is difficult to say when the right time to restructure a banking system. Nae-Youn Lee (2000) and Dominique Strauss-Kahn (2009) suggested that, restructuring the banking system, especially weak banks is implemented when countries face the economic crisis and are pursuing policies to restore the economy. In the past few decades, many countries experienced the bank restructuring process during or after a financial crisis or/and economic crises. When a crisis occurs, depositors, creditors and bank owners usually lose their confidence and find ways to withdraw money from the bank. When a large amount of deposits is withdrawn from the banking system, the problem becomes systematic and threatens the economic stability. Therefore, the government will have no choice but to take action – restructuring. In this condition, there are not many responses for the government to select. This practice has been demonstrated during the Asian financial crisis in 1997. During the financial crisis started in the United States in 2007, the United States also restructured the banking system during the crisis and after the implementation of economic stimulus policies. The stability of the financial system is

considered one of the most important institutional factors for the effective operation of the market economy and the process of economic recovery.

Although restructuring the banking system is often done during and after the crisis, there are cases when some nations experienced restructuring actively their own banking sector before a crisis occurred so it could increase the resilience of banks and helped those countries avoid comprehensive crisis. According to the IMF study (2009), Carl-Johan Lindgren (1999), Paul Krugman (1998), William R White (2008), the active implementation of bank restructuring contributes to resilience of the banking and financial system in fighting back the effects spreading from the crisis. Compared with the three Asian countries with crisis in 1997, Malaysia and the Philippines actively restructured the banking system in the 1980s and avoided comprehensive recession during the Asian financial crisis.

China is one of Asian countries conducting active restructuring and it is also a case but not during the Asian financial crisis. Economists and policymakers of China have evaluated and found that weak management and operation capacity and lack of transparency in the industry are the causes of the weaknesses in the Chinese banking system. From those findings, China has adopted banking reforms in order to switch state-owned banks into real commercial banks which have high competiveness in the market. Besides, the Chinese government has established three policy banks to separate the relevant policy loans (Fu, X and Herffernan, SA, 2009). According to estimates (Guounan Ma), the cost of banking system restructuring is equivalent to 30% of China's GDP and focused on improving the balance sheets of banks.

In all cases of countries actively restructuring the banking system, it is

important that countries need to assess the true state of the banking system, risk measurement or expected losses of the banking system and the economy. The selection of evaluation methods depends on the choice of each country, however, the risks and weaknesses in banking operations are always difficult to be assessed and then measured. Thus, the choice of methods to assess the conditions of information and practical experience is the determining factor to the successful assessment and detection of problems in the banking system.

How to assess the banking system before crisis and the necessity of bank restructuring

(Hawkins and Turner, 1999; Dookyung Kim, 1999) indicated some common signs to imply that the banking system is facing problems or signs of a crisis:

1. Overheating credit growth is much higher than the growth rate of GDP;

2. Huge foreign debt, poor foreign exchange reserves and exchange rate risks are not concerned;

3. Large fluctuations in asset prices;

4. The poor ability to assess credit and manage the credit risk comes along with incomplete information, lack of transparency; and

5. The regulations on banking activities are inconsistent and lax, and banking supervision is not effective.

Not much different, Hawkins and Turner (1999), Goldstein and Turner (1996), Caprio and Klingebiel (1996) have another approach to assess the banking system before the crisis and the restructuring is to analyze the causes of the crisis. The causes of the crisis and the restructuring can be divided into three groups:

Micro factors, including:

- The regulations and practices of banking activities are weak, especially insufficient capital and lending policy violations.

- Issues related to the conflict between the owner and the operator also play an important role, especially in the reward policy to encourage lending staff based on the number of loans without paying attention to risks that banks may face.

- Limits on the level of employees could hinder the adoption of new technologies.

Macro factors: the volatility of prices or macroeconomic factors such as the overheating economy. For example, the 1970s oil shocks in Latin American led to debt crisis in the early 1980s.

Systematic factors: environment is unable to facilitate the development of efficient banking system

Methods used to restructure the banking system

There are many methods can be used to restructure the banking system. Implementation of banking system restructuring requires a combination of measures. In the study of Dziobek (1998), international methods of banking restructuring were mentioned as the following:

1. Government's capital injection or stock purchase to hold management rights

2. Closures of the banks which are unable to survive in an orderly manner (as well as paying deposit insurance or selling well-operated parts for other banks).

3. Merger of domestic banks with foreign banks.

4. Merger of domestic banks.

5. Establishment of asset management company.

6. Change in bank ownership structure (e.g. privatization).

In addition to the above measures, Dziobek (1998) suggested that it is necessary to take macro measures for each institution and legal factor to regulate and restore the problematic banking system in order to ensure sustainable solvency and profitability. For example, to change and reform regulations and policies on banking operations and to supervise the financial and banking system should also need undertaking. Among these measures, changes in bank ownership and privatization bring the most significant changes in the banking system. Next, closures of banks, mergers of banks and government's purchase of stock are also effective methods. In contrast, when the central bank is assigned to be the only agency to restructure or support liquidity, the banking system changes slowly. This shows that not only the methods but also the organization of implementing restructuring and the implementation itself play very important roles.

The topic of the banking system restructuring is always a complex and debatable issue and depend on country, the operational implementation are various although the applications of restructuring methods are similar. This difference is most apparent between the developed countries and the emerging countries, between countries in Asia and Europe and the United States.

2.2 Literature Review on Vietnam Banking Restructuring

While there are a lot of research papers which give us the concepts of

banking restructuring in general, it is unfortunate that there has been little discussion and virtually no significant research work devoted to banking restructuring in Vietnam. These papers mostly focused on analyzing steps in reform and restructuring of Vietnam's banking sector and studying the reform and restructuring as the country moved from plan to market economy which took place in the period before the Decision no. 254 was adopted (2011).

Regarding the transformation of Vietnam banking sector, (Kovsted et al. 2005) analyzed the difficulties and problems encountered in transforming the Vietnamese financial sector from one subordinate to government objectives and goals to an autonomous sector guided by market forces and competitive pressures. In the study, the history of financial sector liberalization is traced and close attention paid to the activities and autonomy of the State Bank of Vietnam, the institution responsible for the supervision and regulation of the financial sector in Vietnam.

In his own research, Leung (2009) summarized Vietnam's developments in the banking and financial sector to date. The research also assesses the system's weaknesses that caused large influences during the macroeconomic turbulence of 2008 and discusses the need for deeper reforms of the country's key macroeconomic institutions. In general, for Vietnam to achieve its goal of becoming a modern industrialized economy, it needs to have world-class public institutions to serve a flexible and entrepreneurial private sector. It is necessary to balance effective policy-making and skillful regulation against profitable risk-taking in the banking and financial markets. All efforts will have intention against a background of commitment to a one-party state where social and political stability still remains supreme.

III. Vietnam Banking System

3.1. History of Vietnam Banking System

The development of the Vietnam banking system has closely linked with the revolution and construction of Vietnam. Before the August Revolution in 1945, Vietnam was a feudal-colonial country under the French colonialists' rule. The banking and credit system was founded and regulated by the French colonialists through the Indo China Bank. On the basis of the new economic and financial policy set out in the 2nd Congress of the Vietnam Workers' Party (February, 1951), President Ho Chi Minh signed Decision 15/SL on the establishment of the Vietnam National Bank – Bank of the first people's democratic state in Southeast Asia in order to carry out five urgent missions: issuing banknotes, managing treasury, carrying out credit policy in order to facilitate production and coordinating with the trade authorities for monetary management and struggling against the enemy.

On January 21st, 1960, the Vietnam National Bank was renamed as the State Bank of Vietnam, in accordance with the 1946 Constitution of the Democratic Republic of Vietnam. Following the liberation of the South in 1975, the takeover of the Republic of Vietnam National Bank and private capitalist banks was a starting point of banking activities all over the country under the banking activity regime of a central planning economy. In July 1976, the country was officially unified and the Socialist republic of Vietnam was founded. Therefore, the 1975-1985 period was the ten-year postwar economic recovery after the liberation and reunification of the country. In this period, Vietnam built up the new banking system under the new government,

establishing a country-wide unified banking system and liquidating the banking system of the previous government in the South. Since1986, this is the period after the open-door economic policy (Doi Moi Policy 1986). The state management function was gradually separated from the commercial credit and monetary functions. The new mechanism of banking operations was built up and gradually improved. From 1988, to implement the government's directions and policies during the period of modernization and industrialization, Vietnam's banking system has been continuously reformed and improved to ensure its important role in national construction and economic development. Banking reform/restructure in Vietnam can be divided into three main phases. The first phase started from 1988 to 1997, this was the period opening the economy to international trade and investment when the large SOCBs separated from SBV, the entry of JSBs and foreign bank branches (one-tier system to two-tier one). The second phase occurred from 1998 and ended in 2007. This is the period after Asian financial Crisis 1997 and Vietnam aimed economic growth to reduce development gap between Vietnam and other ASEAN countries. This is also the period when Vietnam entered into WTO in December, 2006. During this time, Vietnam abolished the direct political control of interest rates, the entry of 100 % FBs, restructure and recapitalize 4 large SOCBs in order to reform the system comprehensively and fundamentally for Vietnam's economic integration with the world and the implementation of WTO commitment. The most recent phase to reform/ restructure Vietnamese banking system is the new restructure program which takes place from 2011 to 2015. Each reform/ restructure period has different background, objective and result but restructure phases have one thing in common is to improve and reform Vietnamese

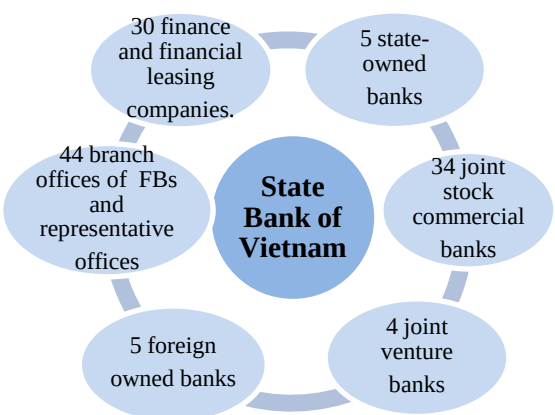
banking system to catch up with the world – class banking standards and create a stable, healthy banking system.

3.2. Structure of Vietnam Banking System

Like most other countries in the world, at top of the Vietnamese banking system is the State Bank of Vietnam which is responsible for issuing currency, managing money and advising monetary policies for the Government of Vietnam, preparing laws on banking business and credit institutions, and managing state-owned commercial banks.

The Vietnamese banking system includes: 5 state-owned banks, 34 joint stock commercial banks, 4 joint venture banks, 5 foreign owned banks, 44 branch offices of foreign banks and representative offices and 30 finance and financial leasing companies. According to World Bank, with this composition, small banks account for a large proportion in the banking sector currently. Most of these were initially rural commercial banks but are now pursuing the strategy of becoming national banks.

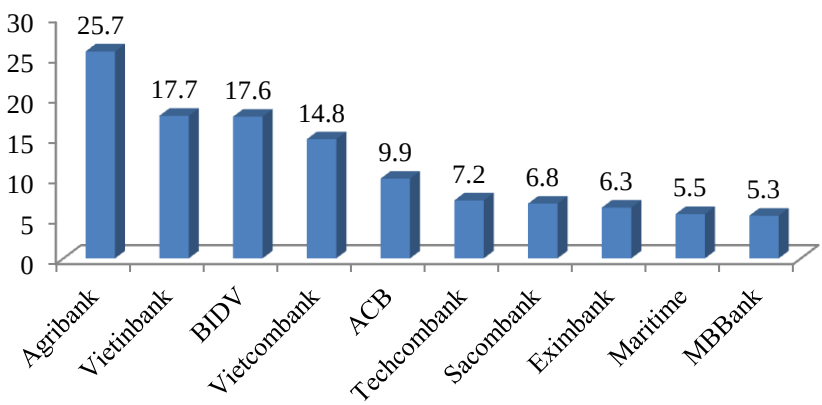
Figure 1: Structure of Vietnam banking system



Source: State Bank of Vietnam

As we can see from the figure below, some of the biggest banks in Vietnam are Vietnam Bank for Agriculture and Rural Development (Agribank), Bank for Investment and Development of Vietnam (BIDV), Vietnam Joint Stock Commercial Bank for Industry and Trade (Vietin Bank), Joint Stock Commercial Bank for Foreign Trade of Vietnam (Vietcombank), Asia Commercial Bank (ACB) and Vietnam Technological and Commercial Joint Stock Bank (Techcombank). Three of the most popular foreign banks in Vietnam are HSBC, ANZ, and Citibanks.

Figure 2: Top 10 Banks by Total Assets (in billion USD, 2012)



Source: based on annual reports of banks

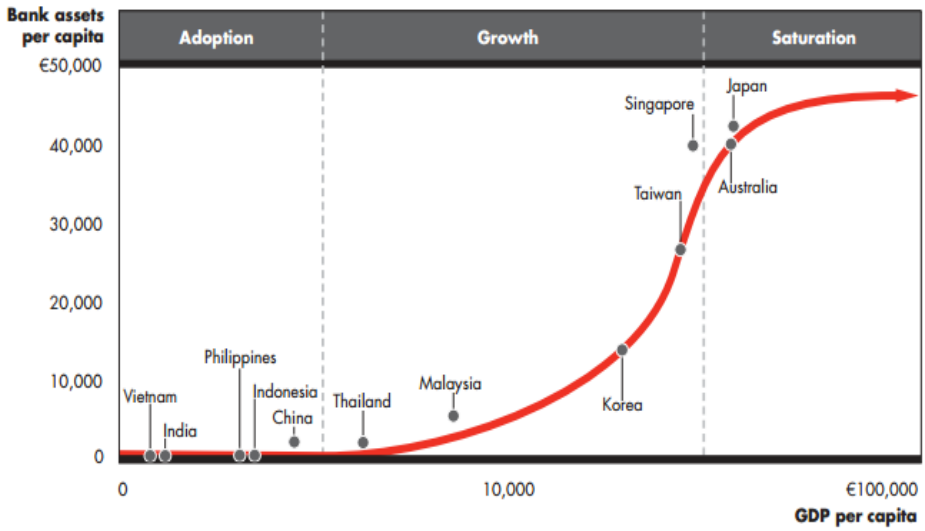
3.3 Features of Vietnam Banking System

3.3.1 Vietnam's banking system in an early stage of development

In comparison with other Asian countries, Vietnamese banking system is still in an early stage of development. As the below figure shows, there are three development stages of banking market development: adoption, growth, saturation and Vietnam banking market is in the initial stage along with India, Phillipines, Indonesia and China. While, Thailand, Malaysia, Korea, Taiwan

and Singapore are in the growth stage and Japan and Australia with developed banking market are in the saturation stage.

Figure 3: Vietnam's banking market is in an early stage of development

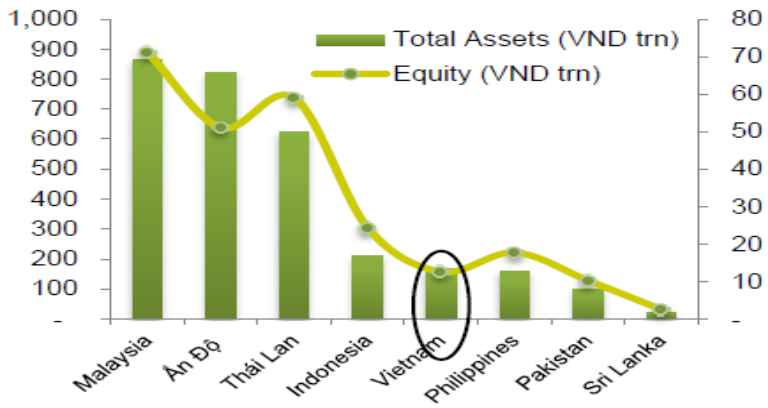


Source: Swiss Re Sigma Report 2006; Population Research Bureau; Lit. Searches; Bain Analysis

3.3.2 Capital size is still small in comparison with other countries in region

In two decades of development, although Vietnamese banks experienced a high growth of the total assets, their capital size was still small compared to other countries in the region. According to Bloomberg, the average asset and equity of eight listed Vietnamese banks was VND 166,844 billion and VND 12,574 billion respectively, lower than those of China, Malaysia, India and Thailand. Therefore, Vietnamese banks are under great pressure to maintain and improve their capital adequacy.

Figure 4: Banking sector size of countries

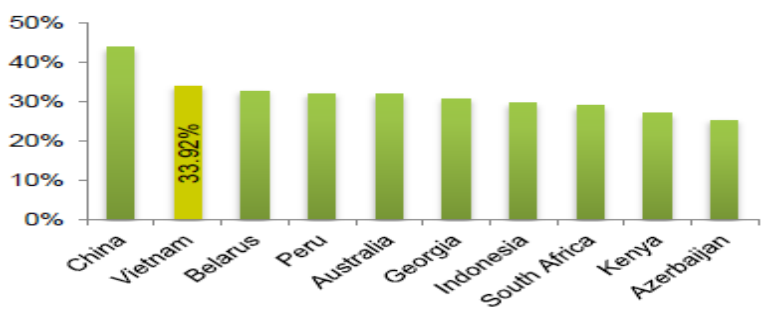


Source: Bloomberg, Vietcombank Securities

3.3.3 High asset growth

Although the size of Vietnamese banking sector is still small in comparison with other peers in the region but the growth of assets has been significantly high in recent years. For example, assets of banking sector doubled in the period 2007 – 2010. According to IMF's data, the total assets of banking sector have doubled from VND 1,097 trillion (USD 52.4 billion) in 2007 to VND 2,690 trillion (USD 128.7 billion) in 2010. In the figure below, Vietnam with the growth of 33.92% was in the top ten countries having the highest asset growth of the banking sector, ranking second after China.

Figure 5: Top 10 countries with highest asset growth of banking sector



Source: Vietcombank Securities

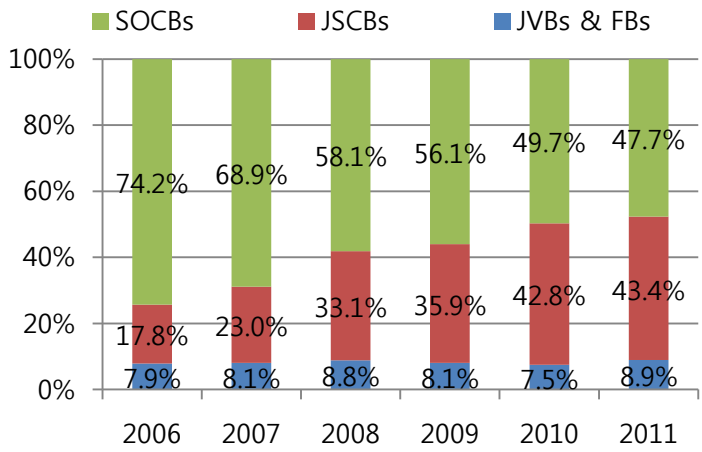
3.3.4 Large State-owned banks' market share

State-owned banks are banks that 100% owned by the Government or partially equitized but the Government is still the largest shareholder. State-owned banks in Vietnam have advantages of large capital size and the Government still holds significant stake in some equitized ones. Their traditional customers are state-owned enterprises (SOEs), which have higher exposure to non-performing loans than other enterprises. According to SBV's statistics, 60% of 2011's non-performing loans were from SOEs.

Although SOCBs' market share has significantly decreased during the period 2006-2011, it is still higher than those of Joint Stock Commercial Banks (JSCBs), Joint Venture Banks (JVBs) and Foreign Banks (FBs). Four largest State-owned banks names Vietnam Bank for Agriculture and Rural Development (Agribank), Bank for Investment and Development of Vietnam (BIDV), Vietnam Commercial Joint Stock Bank of Industry and Trade (VietinBank-CTG) and Vietnam Commercial Joint Stock Bank for Foreign Trade (Vietcombank-VCB) are still dominating the domestic lending market when their combined market share as of the end of 2011 reached 49.3%%, decreasing from 54.1% in 2010[1].

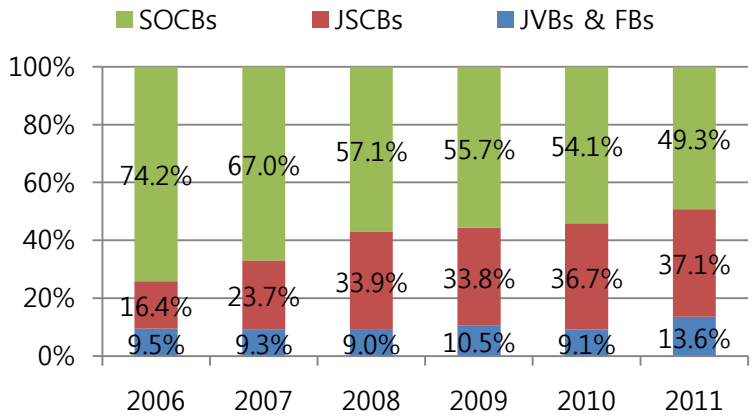
[1] Data from State Bank of Vietnam's annual report.

Figure 6: Deposit market share of Vietnam banks



Source: Vietcombank Securities

Figure 7: Credit market share of Vietnam banks



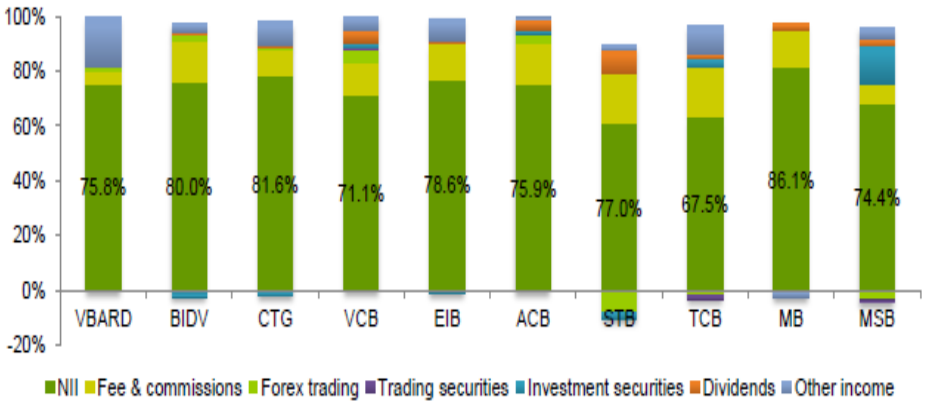
Source: Vietcombank Securities

3.3.5 Income heavily depending on lending

Although Vietnam's banking market has extended aggressively in the last decades, however, like many other East Asian economies, Vietnam has depended heavily on banking lending. Vietnamese banks' income composition is not diversified, mainly contributed by interest income. In 2010, interest income's average contribution to total income of ten largest banks was 76.8%

(figure 8). This figure even reached above 90% for smaller banks like Lien Viet Bank (92.2%), Ocean Bank (103.5%), Navibank (93.1%) and Mekong Development Bank (98.8%). This means that income composition of Vietnamese banking sector has not been diversified due to the main contribution of interest income and it leads to higher exposures to credit risks.

Figure 8: Income composition of 10 largest banks in 2010



Source: Vietcombank Securities

IV. PREVIOUS EFFORT ON BANKING REFORM AND RESTRUCTURE IN VIETNAM BEFORE 2011

Before the Government's Decision no.254 regarding restructuring Vietnam banking system was adopted, the sector had experienced reforming and restructuring many times with different contents and forms over the past decades. The efforts on banking reform and restructuring in Vietnam before 2011 can be traced along with the country's socio-economic development to become a middle-income country. This was achieved essentially through two phases of economic reforms: Doi Moi 1 (1986-1997), and Doi Moi 2 (2001-2007). The success of Doi Moi 1 is to open the economy to international trade and investment (Dollar and Litvack 1998; Leung and Thanh 1996; Riedel 1999). Since the new millennium, Doi Moi 2 began allowing more open policies to the domestic private sector and solved the discrimination inherent in the trade and investment regime, starting with the Enterprise Law in 2000, the Unified Enterprise Law in 2005, the Vietnam-US. Bilateral trade agreement in 2006, and focusing on commitments for Vietnam's entry into the WTO in late 2006. This second phase of economic reforms resulted in rates of economic growth second only to that of China's, fuelled by FDI and remittances, this time linking Vietnam's domestic private sector to the vibrant production network of the Asian region, and shortening the development gap between Vietnam and its original ASEAN neighbor countries (Leung, 2009). In efforts to reform the Vietnamese economy, the banking sector takes central role. Along with two

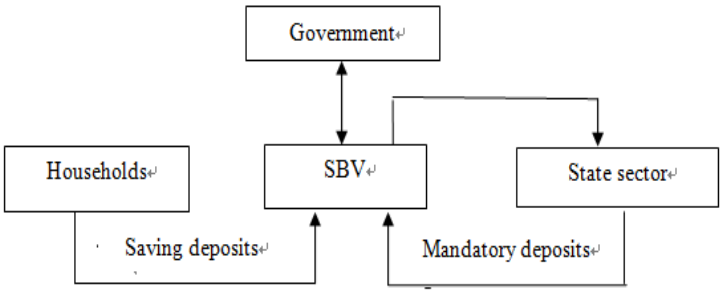
phases of economic reforms, the reform and restructure of Vietnam banking sector before 2011 also can be divided into two phases. Phase 1 began with the banking reforms undertaken from 1988 to 1991 and ends in 1997 with the East Asian Financial Crisis. Phase 2 started from the post-crisis period to 2007.

4.1 First Phase, 1988- 1997

The first phase was initiated by the banking reforms undertaken from 1988 to 1997. These reforms resulted in the creation of a two-tiered banking system through the separation of the large SOCBs from SBV. In addition, the entry of JSBs and FBBs were allowed. This first phase ended in 1997 with the East Asian Financial Crisis.

In the 1980s, the structure of the Vietnamese banking system relied upon a one-tier model typical of entirely administered banking systems in socialist economies. In such a model, SBV had a monopoly on all financial transactions in the country and acted both as a central bank and as a commercial bank. It not only issued banknotes but also practiced other duties such as currency revaluation, budget distribution, and the provision of loans, in order to achieve its main tasks of allocating state funds and serving the state sector. In addition to the SBV, the government owned and controlled Vietcombank, a foreign trade bank, and the Bank for Investment and Development (BFID). They are specialized banks and among their primary obligations, they had responsibility for the allocation of funds to state - owned enterprises.

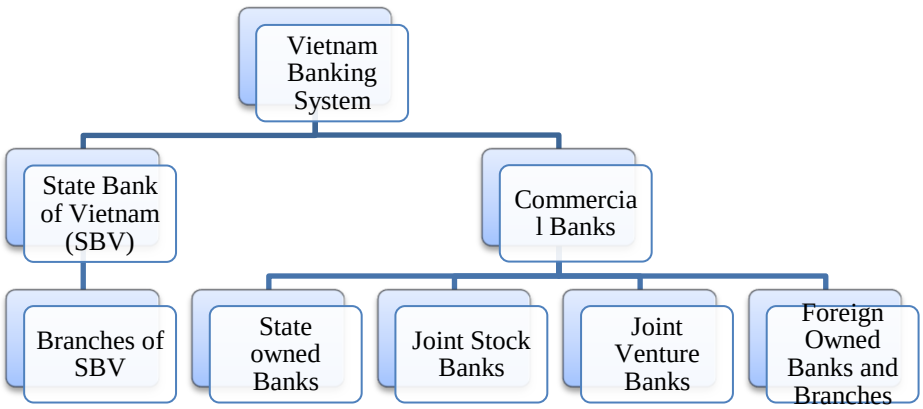
Figure 9: Vietnam's one-tier banking system



However, the restructuring of this model was initiated as a result of the comprehensive reform program launched after the December 1986 Communist Party Congress. Along with the transformation of Vietnam economy from a closed command economy into a market-oriented one, the banking system was vastly reformed into a two-tier model through the separation of the large SOCBs from SBV. In this model, SBV exercise the state regulatory function as a central bank and a commercial bank in charge of sector allocation and credit volume decisions. The establishment of a two-tiered banking system through the transformation of the former mono-bank into SBV and two new specialized SOCBs in 1988 marks the beginning of the structural transformation of the Vietnamese banking system[2]. The new SOCBs that were established included the Vietnamese Bank for Agriculture and Rural Development (VBARD) and the Industrial and Commercial Bank of Vietnam (ICVB).

[2] The stipulated sectoral specialization of the four SOCBs was lifted in 1990. Four SOCBs at that time were the Vietnam Agriculture bank (now VBARD or the Viet Nam Bank for Agriculture and Rural Development), the Bank for Investment and Development (BFID), the Foreign Trade Bank (Vietcombank) and Vietnam Industrial and Commercial Bank.

Figure 10: The current two – tier banking system in Vietnam



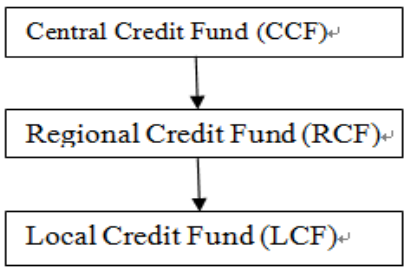
Another structural change that has had lasting and very important implications for the Vietnamese financial system is the fast collapse of the credit cooperative system. The credit cooperatives of this epoch were operating in isolation in small communities beyond the reach of the former mono-bank. They were the sole source of funding in the local areas, the credit cooperatives attracted the majority of the local savings by offering very attractive rates (sometimes up to four times the rates on offer from other financial institutions) (Le Roy and Robert, 1999). In the mid-1980s, the number of Credit Cooperatives (CCs) grew rapidly and they were well known and established financial institutions in Vietnam. The first credit cooperatives were established in North Vietnam in 1956 and they numbered 5,500 already in the early 1960s. By 1983 the first CCs were established in South Vietnam, and their number continued to grow rapidly during the mid-1980s. By the end of the decade their number stood at 7,180. However, early during 1990, the credit cooperatives encountered difficulties when the government implemented anti-inflationary

policies and a number of measures intended to reduce the overall fiscal deficit[3]. The enforcement of these reforms contributed further to the collapse of the credit cooperatives when government subsidies dried up and depositors panicked and rushed to withdraw their money. The lack of refinancing facilities, back-up funds and deposit insurance implied that the majority (over 7,000) of the isolated credit cooperatives went bankrupt resulting in massive and devastating losses of savings of especially agricultural households. By the end of 1990 only 160 credit cooperatives were operational, the rest had closed due to mounting arrears (J.Kovsted, 2003).

The government reacted to the crisis in the credit cooperative system by strengthening the monitoring role of the SBV and by granting more autonomy to the SOCBs to create a more competitive environment. The government also attempted to fill the financing gap caused by the virtual disappearance of the credit cooperative system by strengthening the newly formed VBARD and by decree no. 202 of 6 August 1991 to lend directly to peasant families. However, only VBARD could not fill the void from the collapsed rural credit cooperatives. This leaded the government to entrust the SBV with the creation of a new network of local credit windows named "People's Credit Funds" (PCFs) to replace credit cooperative system.

[3] Anti-inflationary policies Vietnam government used at that time included sharp increases in the interest rate, a devaluation of the exchange rate, and limits to credit expansion. Measures the government implemented to reduce the overall fiscal deficit were the elimination of budget subsidies, the reduction of credit to state enterprises, as well as streamlining the bureaucracy.

Figure 11: Three-layer model of People's Credit Funds in Vietnam



In this hierarchical organization, Local Credit Funds (LCF) which were meant to effectively replace the former credit cooperatives would be handled and directed by a Regional Credit Fund (RCF), which in turn would be supervised by a Central Credit Fund (CCF) handling the supply and balancing of liquidity among the regional funds. If the distance from a LCF to a RCF were too long – the LCF would be managed directly by SBV.

Along with constraint of the crisis in the credit cooperative system throughout 1990, the government also passed new legislation intended to further the diversification of the financial sector. The enactment of two important banking decrees, the "Ordinance on the State Bank'' and the "Ordinance on Banks, Credit Cooperatives, and Financial Companies" in May 1990 affected the formation of the two-tier banking system and allowed further foreign bank participation and the progressive establishment of 54 JSBs. In subsequent years financial institutions have become even more diversified: the system now includes SOCBs, JSBs, JVBs, subsidiaries of FBs, credit cooperatives, people's credit funds and other financial companies.

In 1997, the ordinances were upgraded into laws to match the demand of diverse financial activities. The current legal framework for banking activities was basically completed with the enactment of the "Law on the State Bank" and

the “Law on Credit Institutions” in December 1997. These measures not only helped recognizing and protecting business operations by the state-owned commercial banks, but also encouraged the development of other financial institutions on the basis of equal treatment to create a competitive environment, transparency, and publicity in banking operation.

4.2 Second Phase, 1998- 2007

The second banking reform/ restructuring phase extended from the post Asian financial crisis period until 2007. This is the period 10 years after Vietnam economy transformed from a centrally coordinated to market oriented one. Effects from Asian financial crisis coupled with the fact of being a transition economy, the task of reforming the financial sector was even more pressing in Vietnam, particularly in the face of the challenges presented by globalization. The most significant steps include the deregulation of domestic interest rates (on both dong and foreign currency deposits and loans) during the period 1996–2002, the decision in May 2005 to restructure the state-owned commercial banks and have them equitized by 2010, and of course the decision to permit 100 percent foreign-owned banks to enter the market as per commitment to WTO. Meanwhile, the exchange rate is still administered and exchange controls remain in place.

The second phase began with the adoption of the Banking Law in 1998, which strengthened the autonomy of the SBV and abolished the direct political control of interest rates. Although Vietnam was not directly involved in the regional financial crisis of 1997-98 like Indonesia, Korea, Malaysia, nevertheless, the impact of the crisis was severe. One of the observed direct

effects of the crisis was that enterprises, expecting a devaluation of the VND, chose to hold foreign currency rather than sell it to the banks. This led to an excessive demand for foreign currency on the inter-bank market, which left the SBV with the burden of supplying foreign currency until a decree was passed requiring firms to sell 80 percent of their foreign exchange to banks (this was later reduced to 50 percent). The SBV furthermore decided upon a 10 percent devaluation of the official exchange rate to the US dollar in August 1998, thereby reducing the perceived pressure for VND devaluation and the demand for foreign currency.

There were the policy responses to stabilize and support the crisis-stricken SOEs through the SOCBs during 1998 included:

- Abandoning the requirement for SOEs to put up collateral when borrowing from SOCBs
-Permitting lending to loss making SOEs who submit business plans
-Writing off bad loans
-Lower interest rates to SOEs
-Allowing the rescheduling loans to troubled SOEs from 1-3 years terms to 1-5 year terms

The effects from the economic crisis combined with the support for SOEs put a heavy financial burden on the SOCBs and led to increasing problems during 1998-1999. In response to these problems, the government gave compensating measures to the SOCBs to prevent the possibility of a crisis:

- Lowering the income tax rate for the banking system from 45 to 32 percent (January 1999)
- Lowering the reserve requirement ratio from 8-5 percent (March 1999)

- Direct allocation of funds (September 1999)

In 2000s, the first priority on structural reforms in the banking sector was to restructure and strengthen the JSBs under the government initiative to enhance their financial management ability. The SBV completed the financial assessment of 48 JSB by the end of 2000, and on the basis of these the SBV completed and approved restructuring plans for all 48 JSBs. As a result, 13 of the 48 JSBs were placed under special supervision/ control by the SBV and many mergers and acquisitions also took place directed at weak banks and the number of JSBs in this period decreased remarkably compared with the period before 1999 (as we can see from the table below).

Table 1: Number of banks in Vietnam 1991 - 2010

Year	**1991**	**1993**	**1995**	**1997**	**1999**	**2001**	**2003**	**2005**	**2007**	**2008**	**2009**	**2010**
SOCBs	4	4	4	5	5	5	5	5	5	5	5	5
JSCBs	5	44	52	55	52	43	40	42	39	45	42	42
FFOBs	0	0	0	0	0	0	0	0	0	5	5	5
FBBs	0	8	18	24	26	27	27	31	41	39	40	48

Source: The State Bank of Vietnam annual reports

The restructuring process was not only restricted to the JSBs, in March 2001 the government approved an overall SOB reform framework. The objective of this framework is to enforce better lending discipline and the phasing out of policy lending is furthermore made conditional on the establishment of a policy bank, which is responsible for issuing all new policy loans. Each of four large SOCBs underwent a phased recapitalization and reforms/ restructuring in a number of areas in order to increase the transparency of SOCB operations and include independent audits based on international accounting standards of each bank and ensuring that loan classification are more

suitable with international standards. In addition to the efforts to restructure and recapitalize the SOCBs, the government also aimed to reduce SOCB/SOE interdependence.

In August 2000, a more flexible interest rate mechanism was introduced. This allowed banks to set lending rates along with a further relaxation of controls. In November 2001, the interest rate ceilings on foreign currency loans were abolished, giving Vietnamese lenders the opportunity to negotiate for foreign currency loans in both overseas and Vietnamese based banks. The banks in Vietnam can set interest rates on foreign currency loans at their own discretion , however, lending in VND is still subject to an upper limit on interest rates, which is defined as the base rate plus 0.3 % for short term loans and plus 0.5% for medium to long term loans. Along with a more flexible interest rate, the government also gradually eased the control of the exchange rate. Initially, the government had set the exchange rate through adjustments in the official rate and/ or the width of the trading band. However, in February 1999, the SBV abolished the official rate and defined the exchange rate through the interbank markets only.

Another milestone affecting Vietnamese banking reform/ restructuring in this period is the US bilateral trade agreement (2001) and Vietnam's accession to WTO (2006). These provided opportunities for more reforms in the banking sector. Notably, under the framework of the US - Vietnam Bilateral Trade Organization, the Vietnamese authorities committed themselves to liberalize the banking system by 2010. The scope of Vietnam's obligations is extended to all WTO member countries, according to the most favored nation principle. These reforms grant foreign banks the right and opportunity to expand the scope of

their activities in the Vietnamese banking sector, especially because it enables foreign banks to access a greater share of the capital of Vietnamese banks. The agenda has been formally set up by the Vietnamese authorizes in a roadmap for the 2006-2010 periods. It anticipated a major reform of the SBV and the banking sector regulation, which enabled the implementation of the Basel I prudential indicators. It also includes a partial privatization of the SOBs and further privatization of other banks (under that time regulation, a foreign bank standing alone and a pool of banks are limited to owning respectively no more than 15 and 30 % of a Vietnamese bank's capital). At this time, four of five SOCBs have been equitized (Vietcombank in 2007, Vietinbank in 2008, BIDV in 2011 and Mekong Housing Bank in 2011) with the state retaining up to 90 percent of shares in each bank following the initial public offering. Following the implementation of the WTO commitment from 2008 onwards, five fully foreign-owned banks, which are commercial banks 100% owned by FBs were established (Table 1). The SBV permitted HSBC, Standard Chartered, ANZ Bank, Korea's Shinhan Bank and Malaysia's Hong Leong Bank to establish entirely foreign-owned subsidiary banks incorporated in Vietnam.

The second phase can be summed up as a gradual progress to the more comprehensive and fundamental reforms of the banking sector following the East Financial Crisis in the 1997-1998. However, reforms were still at an initial stage and it needs the further efforts to restructure and recapitalize the SOCBs and their NPLs in particular in order to introduce a more market-based financial sector.

V. BANKING RESTRUCTURING PROGRAM IN VIETNAM AFTER 2011

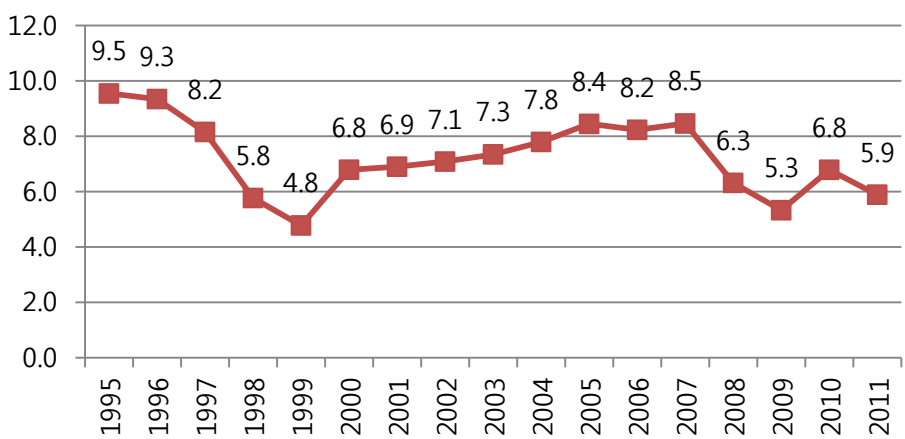
5.1 Background

After decades of remarkable growth and impressive poverty reduction, since 2007 Vietnam economy in general and banking sector in particular has been facing problems: high inflation and declining growth rate, boom and bust in real estate sector, high inefficiency in state investment and state-owned economic groups, growing bad debts and banking instability, high interest rate and credit freezing, massive bankruptcy in private sector etc.

Declining growth rate

As we can see from the figure below, since global economic crisis in 2007, Vietnamese economy also suffered severe effects and the growth rate of Vietnamese GDP declined significantly from the high growth rate of 8.5 in 2007 to 5.9% in 2011.

Figure 12: GDP growth of Vietnam in the period 1994 -2011 (%)

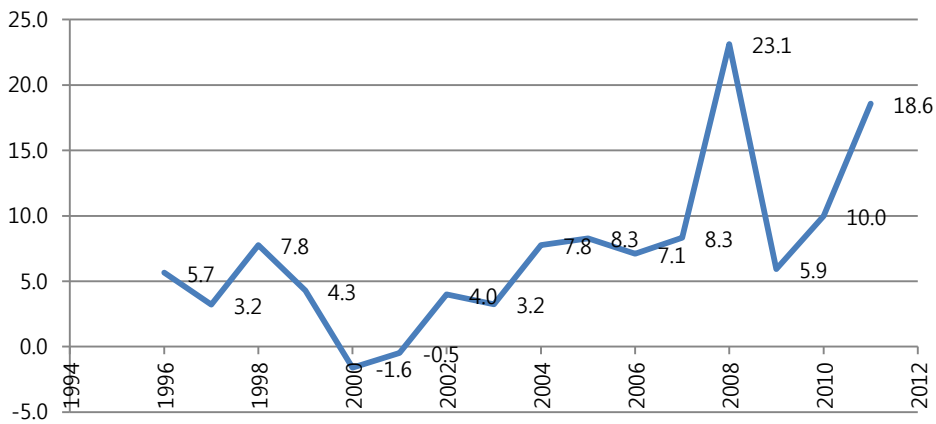


Source: Author's calculation based on data from Asian Development Bank (ADB)

Surging inflation

Along with the decline of the growth rate, Vietnamese economy also faced with the high inflation rate. Vietnam's inflation rate in 2011 is estimated to be 18.6%, increasing 8.6% from the previous year. During the year 2008, the country had witnessed inflation rate of 23.11%, the highest recorded since 1996.

Figure 13: Inflation rate in Vietnam in the period 1996 – 2011 (%)

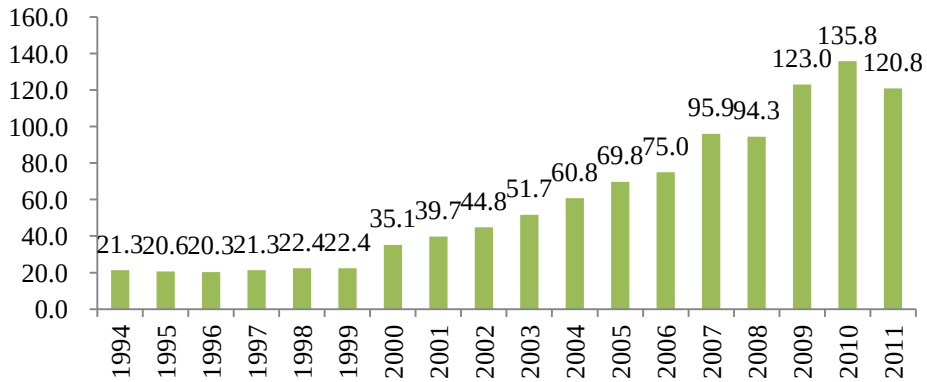


Source: Author's calculation based on data from Asian Development Bank (ADB)

Overheating Credit Growth

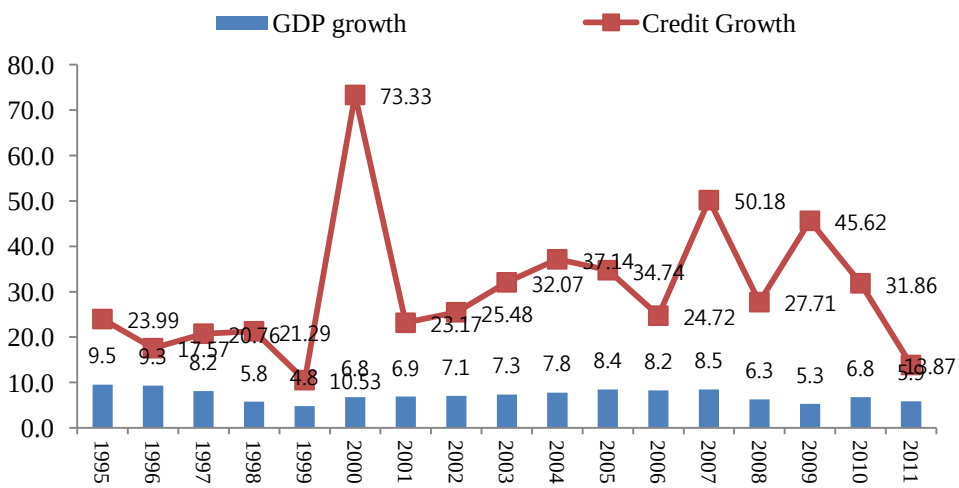
At the same time, Vietnamese economy also exposed one of signs to imply that an economy is facing with the crisis, which is overheating credit growth. The credit growth in Vietnam is much higher than GDP most of the time. The fact that the credit growth is much higher than deposits and GDP growth may cause liquidity risk for the sector in particular and for the economy in general.

Figure 14: Vietnam's Credit/ GDP Ratio



Source: Author's calculation based on data from Asian Development Bank (ADB)

Figure 15: Comparison between GDP growth and Credit growth



Source: Author's calculation based on data from Asian Development Bank (ADB)

The average credit growth during 2000 – 2010 was 32% while the average growth of deposits and GDP were 29% and 7.15% respectively. According to some researches of economic experts, credit growth ranging from 14% to 20% can generate a GDP growth of 7% without causing a credit bubble. However, when this figure exceeds 20%, the health of the economy may be

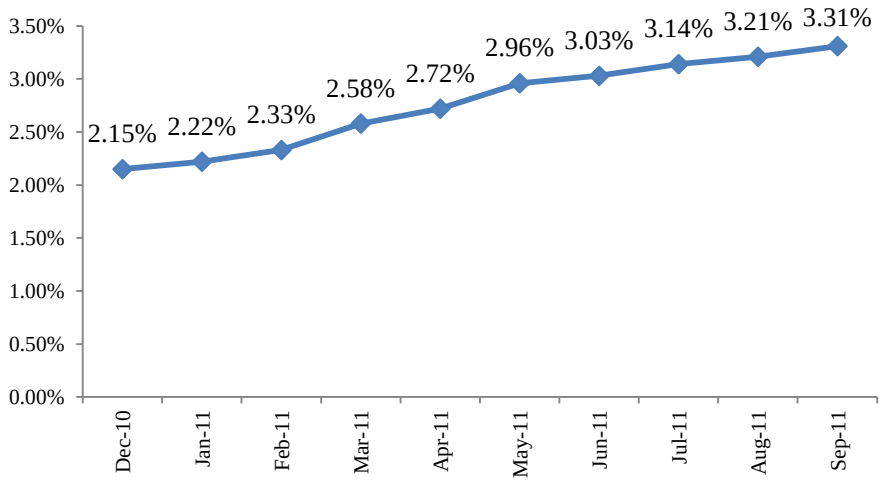
threatened. In addition, credit growing faster than deposits in most of the years also caused the liquidity problem for the banking sector. This is one of the reasons why international rating institutions like Fitch, S&P and Moody's downgraded Vietnam credit rating in 2010, stemming from their concerns about too high credit growth.

High level of Non-performing loans

Non-performing loans is always an inherent problem to Vietnamese banks. High credit growth and inefficient credit management are two main reasons causing the recent increase of NPL ratio. The volume of banking sector assets grew at a much faster rate than the normal economic activities. In particular, commercial bank loans increased by 30% per annum during the 2008-2010 period while GDP rose by only 6-7% per year. Banks created heavy money supply into the economy, resulting in double digit inflation, and as firms had been able to access cheap funding easily in these years, they had either invested heavily but not prudently or invested in risky projects. The consequence is that firms are now unable to service their debts and rising level of NPLs is a serious problem for banks.

In early 2012, the SBV announced that the amount of NPLs at end-2011 was $3.8 billion, a 70% increase from end-2010 and equal to 3.31% of all loans, and then on 11 April, 2011 SBV president, Nguyen Van Binh, revised up this figure to a range of 3.6% to 3.8%.

Figure 16: Non-performing loan ratios



Source: Saigon Securities data

The reality is that it is difficult to accurately estimate the amount of loans that are nonperforming. This is because valuing NPLs can become tricky when the currency is constantly being devalued, inflation is raging, and the policy rate is frequently being changed. Moreover, the definition of what constitutes a nonperforming loan is rather vague under Vietnam's accounting standards relative to under international accounting standards, however, it is likely that the actual amount of NPLs is at least double the official estimate; in fact, the SBV president has publicly acknowledged that the actual NPL ratio is higher. At any rate, until some trustworthy data on NPL becomes available, it will not just remain difficult to value the banks, it will remain impossible to estimate the impact that NPLs can have on the entire banking system. Accordingly, this difficulty in getting a handle on NPLs will probably become a destabilizing factor for the banking system as a whole.

Cross – ownership's risk in Vietnamese banks

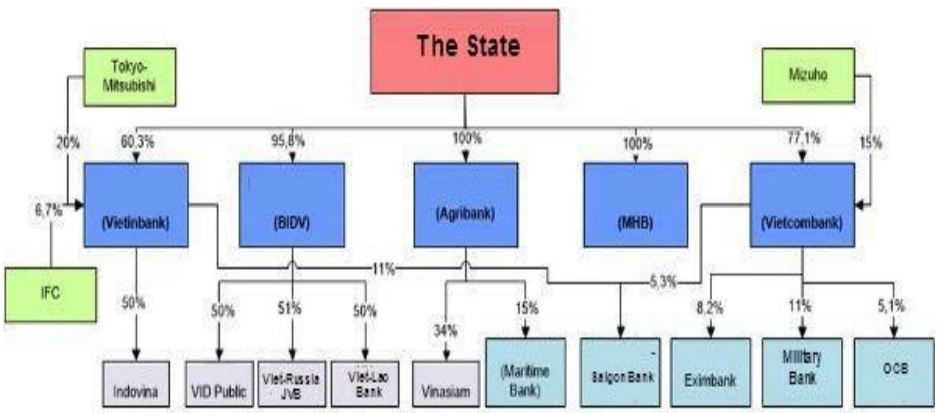
Cross ownership is a complex problem of the banking sector in Vietnam.

The cross-ownership network in Vietnam is very complicated and little information is disclosed. The key attribution to the problem was the government's loosening monetary policy during the five years from 2006-2011 which led to the explosion of credit activities. There were three main changes in the banking system that seriously leaded to cross-ownership problem in Vietnam. In 2006, the minimum charter capital was increased to 1 trillion VND; in 2008, it rose to 3 trillion VND; and in 2011, the restructuring process started by merging three joint stock commercial. The purpose credit institutions created networks among themselves is to meet the increasing demand of big credit and to ensure a steady capital supply to their clients. Due to the pressure for growth and in order to shorten their administrative procedure including the evaluation and appraisal of paper work, the banks adopted a tendency to lend money among themselves. According to National Finance Supervision Committee (NFSC), cross-ownership and cross-investment issue of credit institutions in Vietnam becomes more serious and is divided into 6 groups. These six groups include: (1) ownership of state-owned lenders and FBs in JVBs; (2) foreign strategic shareholder in local banks; (3) shareholders of commercial banks previously as management companies; (4) ownership of SOCBs in JSC banks; (5) cross-ownership among JS banks; (6) Ownership of JSC banks by state and private corporations.

The cross-ownership among state-owned lenders and JSC banks is the most common and obvious. Four SOCBs, namely Vietcombank, VietinBank, Agribank, BIDV, all hold large stake in and become strategic shareholders of JSC banks.

Typically, Vietcombank owns 11% stake in Military Bank, 8.2% stake at Eximbank, 4.7% stake in OCB, and 5.3% stake in Saigonbank. Meanwhile, Agribank holds 15% stake at Maritime Bank (indirectly through Agriseco), 11% stake in Saigonbank. VietinBank also owns 11% stake in Saigonbank[4].

Figure 17: Cross- Ownership in State-Owned Banks in Vietnam

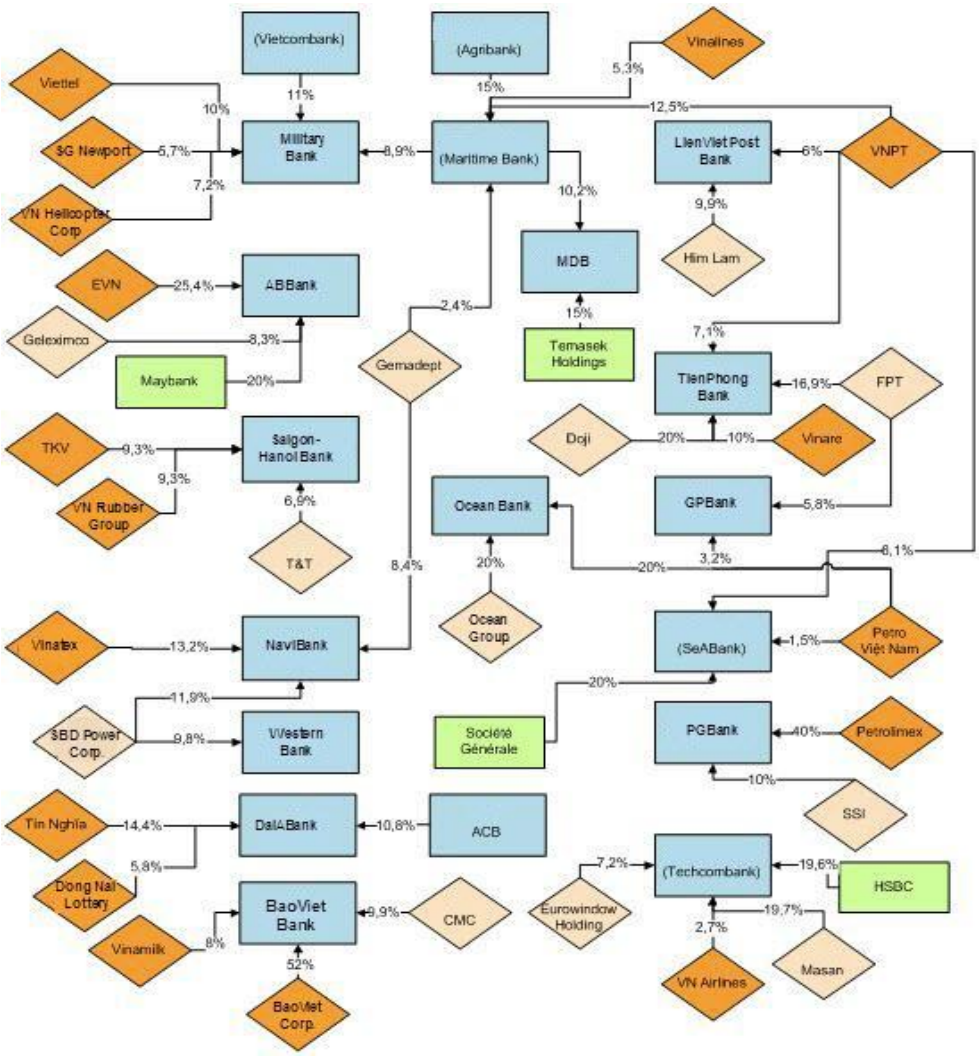


Source: According to Fulbright's research regarding Cross-ownership in Vietnam

Besides, the NFSC said there were many State economic groups and private corporations that made long-term investments as founders and strategic investors in commercial banks. Although these corporations hold a relatively large volume of shares in JSC banks, they do not directly involve in the bank governance and leave the bank management in hands of interest groups or a few individuals. Statistics showed that there were about 40 state-run and privately owned enterprises holding more than 5% stake in commercial banks and they also had ownership in financial investment companies.

[4] According to Fulbright's research regarding Cross-ownership in Vietnam

Figure 18: Cross-Ownership of state economic groups and private corporations in Vietnamese banks



Source: According to Fulbright's research regarding Cross-ownership in Vietnam

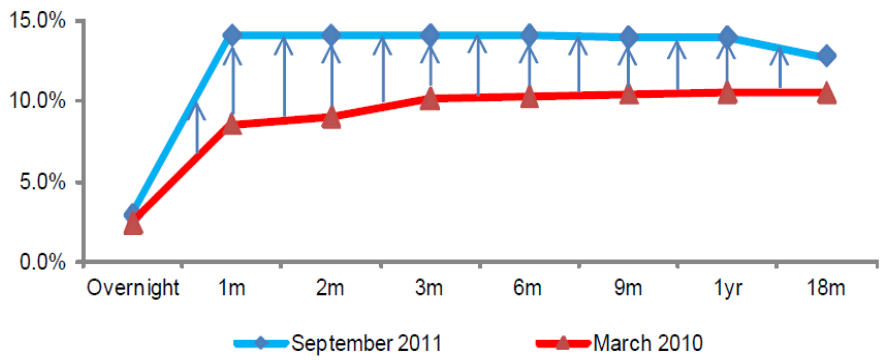
The cross-ownership among JSC banks is also quite common in Vietnam. Typically, ACB owns 20% stake in Eximbank, while Eximbank owns 10.3% stake in Sacombank and 8.5% stake in VietABank.

Liquidity Shortage

After the deposit rate was capped at 14% in 2011, the yield curve became inverted, reflecting a decline in liquidity (Figure 19). While some commercial

banks started paying deposit rates of around 20% well above the legal limit of 14%, in order to attract deposits, the smaller banks were forced to turn to the interbank market to obtain short-term funding. In step with this decline in liquidity, the 1-month interbank lending rate momentarily rose to 30-40% in October 2011, while the overnight rate was at least 7% at the end of June 2012[5].

Figure 19: The capping of deposit rates and the yield curve



Source: data from STOXLUS

5.2 Policy Directions of Vietnam Banking Restructuring 2011-2015

Recognizing the urgency of problems Vietnamese economy and banking sector have been facing, in early 2011 the Vietnamese government announced Resolution No. 01/NQ-CP which highlighted the importance of the economic recovery and socio-economic development. In the new socio-economic development plan, Vietnam aims to achieve these targets: (1) keeping inflation below 10%, (2) restraining the budget deficit to 4,8% of GDP and the trade deficit to 12% of total exports, (3) raising the amount invested in economic

[5] According to report of Nomura Institute of Capital Markets Research on "Vietnam's Plans for Banking Sector reform and the Potential for Industry Restructuring"

development equivalent to one-third of GDP, and (4) raising economic growth from 6% to 6.5%. It proposed seven measures to achieve these targets, one of which was the rapid reform of the banking sector[6].

In response to the requests and the above-noted socioeconomic development plan, the SBV announced the schedule to restructure the banking system for the 2011- 2015, approved by the Prime Minister of Vietnam on 1 March 2011 under his Decision No.254/QD – TTg. The schedule puts strong emphasis on Vietnam striving to have at least one or two banks operate in regional scale by 2015 and State-owned commercial banks playing an important role in restructuring the banking system. Moreover, foreign banks will be encouraged to buy shares in weak banks, to compete equally and increase business operation with domestic banks.

5.2.1 Purpose

The purpose of this new reform program is to restructure the banking system thoroughly and comprehensively, expecting local banks to achieve safe operation and sustainable performance with diversified structures of ownership, sizes, and types to be more competitive and consistent with international standards and meet the demand for financial and banking services of national

[6] The seven measures proposed in the 2012 socioeconomic development plan were (1)implement a strong and flexible monetary policy, conduct efficient fiscal management, monitor the market, and strength the trade deficit, (2) place a priority on allocating resources to revive the economy and pursue a growth model to strengthen productivity and competitiveness (the Prime Minister requested rapid reform of the banking sector from the SBV and requested a plan to rebuild private-sector investment from the Ministry of Planning and Investment, (3) improve the quality of human capital encourage the application of science and technology to the economy, (4) provide social welfare guarantees, reduce poverty, and improve the quality of health care service, (5) strengthen measures to prevent damage from natural disasters, protect the environment, and deal with climate change, (6) finalize a legal framework, encourage administrative reform, and stop corruption, and (7) strengthen national defense and seek improvement in diplomatic problems.

economy. It is necessary for banks to improve their safety and the operational capacity as well as improve market discipline in banking operation. This reform also emphasizes the dominant role of state-owned commercial banks and their aims of pursuing the scale and management efficiency to become competitive not only domestically but also overseas. By the end of 2015, Vietnamese banking sector is expected to form at least one or two commercial banks becoming significant regional players in terms of scale, management quality, technology, and competitiveness.

5.2.2 Main measures

Restructuring State-owned Commercial Banks

The reform emphasizes the important role of SOCBs to the whole banking sector. Therefore, in order to reform the state-owned commercial banks, which is crucial to restructuring the banking sector, problems must be dealt with using a comprehensive approach, as outlined below.

- Enhance the leading role and dominant position of SOCBs;
- Ensure that SOCBs are the main force of the whole system with large scale, safe and efficient operation, advanced management capability, and enhanced competitiveness both at home and abroad;
- Further promote the equitization of SOCBs, including Vietnam Bank for Agriculture and Rural Development (Agribank)[7]; ensure that the State holds controlling shares at the State-owned commercial banks after their equitisation;
- Control bad debts of SOCBs below 3% of total loans pursuant to the Vietnam Accounting System;

[7] Agribank is Vietnam's largest bank in terms of assets, number of employees, and number of customers. It was spun off from the SBV in 1988. Loans to primarily regional farmers account for 70% of its entire loan book.

- Diversify capital raising methods;

- Control credit growth in consistency with the size and term structure of deposits; gradually reduce loan-to-deposit ratio to below 90% by 2015.

Recapitalize to ensure adequate capital and compliance with Basel II by 2015

- Promote mergers and acquisitions in the banking sector

- Improve risk management and internal controls and update bank management systems in accordance with global standards

- Expand the bank branch network (particularly in provincial areas)

- Encourage state-owned commercial banks to expand into overseas markets

- Enhance online banking

- Gradually reduce investment in nonfinancial and high-risk sectors, promote investment aimed at encouraging the development of infrastructure, exports, agricultural and provincial areas, the manufacturing sector, and small businesses

- Quickly foster the development of talented management personnel and instill staff with workplace ethics

Restructuring Commercial Banks and Finance Companies

Joint stock commercial banks, finance companies and financial leasing companies will be assessed with respect to their financial conditions, operation, management, especially quality of their assets, liabilities, capital and safety levels to be classified into three groups:

- healthy
- temporary short of liquidity; and
- weak

The Schedule provides measures to restructure the three bank groups, including reorganization, merger or acquisition, reform of risk management

systems, or intervention by the SBV or other agencies.

The SBV will create favorable conditions for healthy credit institutions to further develop and extend refinancing credits for banks in lack of liquidity.

As for weak credit institutions, they are encouraged to merge with each other voluntarily. A tougher measure will apply in the case of weak banks not wanting to merge voluntarily: they will be enforced to merge, or the SBV will buy or direct other commercial banks (including foreign credit institutions) to buy back their shares.

In addition, they will be closely and comprehensively supervised by the SBV in terms of management, governance, financial conditions and operation.

The Schedule also highlights the solutions and details roadmaps to strengthen and develop People's Credit Funds, microfinance institutions and foreign credit institutions.

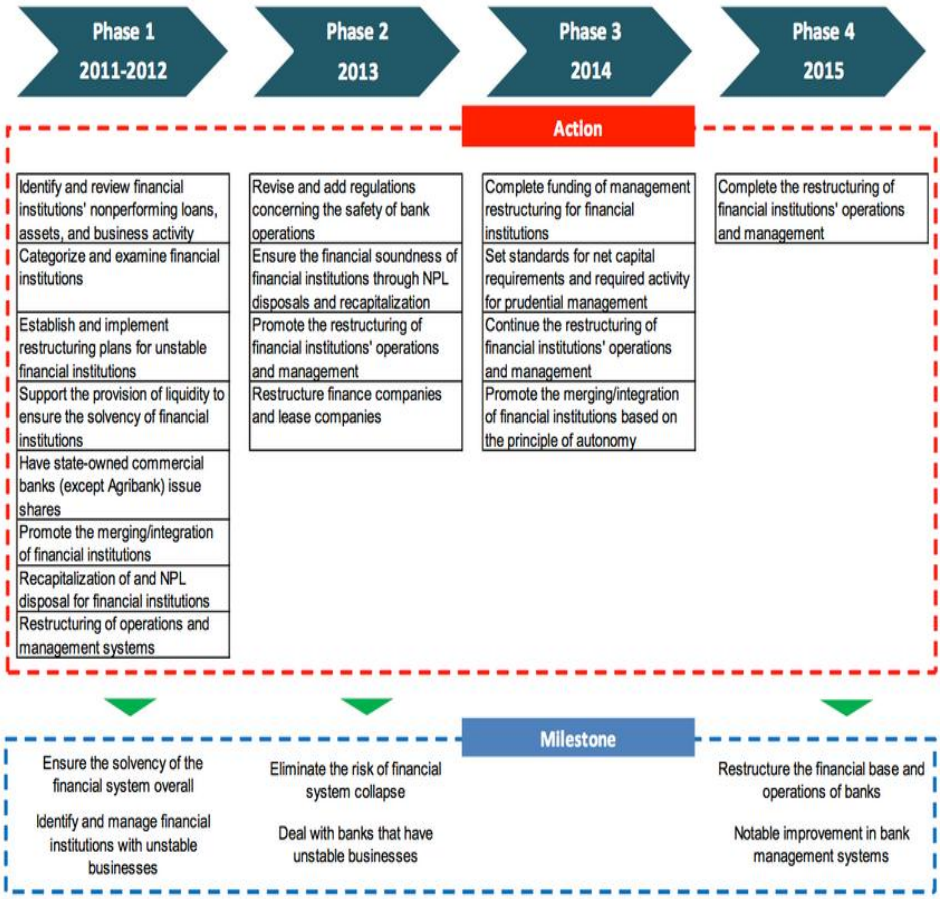
Restructuring Foreign Credit Institutions

Under the Schedule, foreign banks will be encouraged to compete equally as well as to conduct business cooperation with domestic credit organizations. Close links between domestic and foreign credit institutions will also be called for to help develop products, improve governance and modernize technology. Foreign ownership ratios will be increased, particularly for weaker joint stock commercial banks. Foreign credit institutions may contribute capital and purchase shares in weaker domestic entities, while parent institutions overseas are requested to guarantee the payment capacity of their affiliates in Vietnam.

5.2.3 Implementation schedule

The roadmap for implementing the schedule is broken down into four phases, aimed at completion by 2015, as shown in the following figure.

Figure 20: Restructuring Implementation Schedule



Source: Nomura Institute of Capital Markets Research

5.3 Progress in Vietnam Banking Restructuring after 2011

5.3.1 Tackling Non-performing Loans

The high rate of NPLs is one of key problems in Vietnam's banking sector and the resolution of NPLs has become imperative than ever. There are many methods of handling NPLs in Vietnam proposed over this time.

5.3.1.1 Establishing Vietnam Asset Management Company

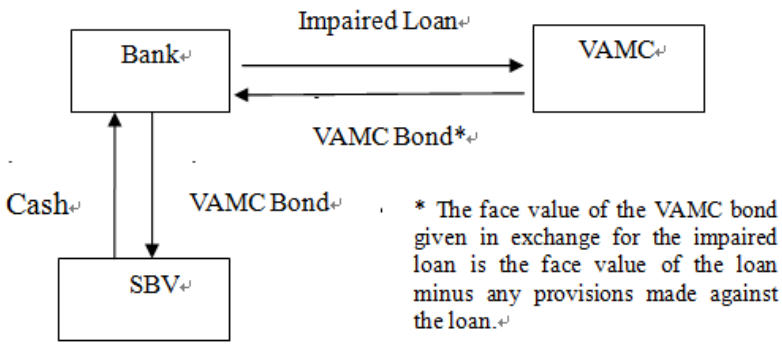
Though Vietnam has an existing state-owned asset management company to handle distressed debts, there is necessary to create a separate asset management company to exclusively handle NPLs in the banking sector. On 18 May 2013, the government issued Decree No.53/2013/ND-CP on the establishment, organization and operation of Vietnam Asset Management Company (VAMC) which came into effect on 9 July 2013 (Decree 53).

The establishment of VAMC is designed to alleviate the burden that NPLs have placed on the balance sheet of Vietnamese commercial banks and other credit institutions. Basically, VAMC will purchase the debt from the credit institutions and assume the position of the lender with respect to rights to enforce security, and authority to negotiate interest forgiveness, forbearances, and restructurings. However, the VAMC was established with only US$25m capital, so it has not actually been buying banks' bad loans, it has been acting as a warehouse until an end-buyer for the loans can be found. If no end-buyer can be found, then the bad loans will be written off over five years. The sale of a bank's bad loans to the VAMC can be viewed as a sale with recourse because the original bank will get the bad loan back if no buyer can be found.

The detailed mechanics of the current VAMC scheme are described as following: banks will transfer their impaired loans to the VAMC in exchange for pieces of paper issued by the VAMC called "special bonds" or "VAMC bonds". As can be seen below, this transaction, which is referred to as an "asset swap" in the local business press, can be considered a sale with recourse. The tenure of the VAMC "bonds" is five years but as they do not carry any coupon, the VAMC-issued papers are not really bonds. The face value of the so-called

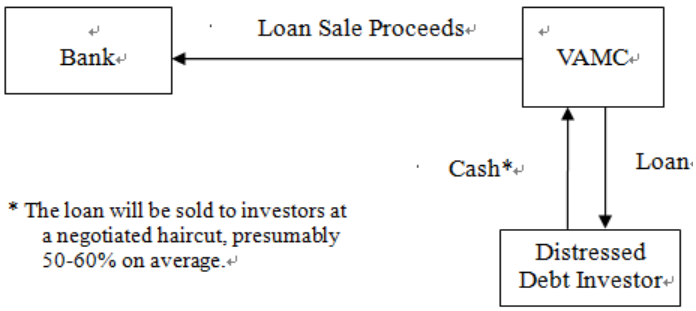
"bonds" issued by the VAMC in consideration for the purchased, impaired loan will be equal to the face value of the loan minus any provisions made against that loan. Next, banks are permitted to use the VAMC bonds as collateral to borrow 50% of their loans' book value from the SBV in newly-printed money.

Figure 21: The VAMC scheme: initial asset swap



After a bank sells or "swaps" a bad loan with the VAMC, it will immediately begin writing down the loan's value to zero over the next five years while the VAMC will try to sell the impaired loans to distress-debt investors at a negotiated haircut, presumably 50-60% on average or in an open auction process. The VAMC will pass on the cash proceeds from the loan sale minus a brokerage fee to the bank that originally held the loan. The exact amount of the brokerage fee has not been clarified and there have been no transactions as yet as the scheme just recently became operational but figures between 2% and 15% have been mentioned by the press. If no buyer can be found after five years, then the original bank will take the loan back on its books but at that time, the loan will have already been written down to zero value.

Figure 22: The VAMC scheme: loan sale to end buyers



With specific mechanism and power described as above, VAMC is capable of fast processing a large volume of NPLs. VAMC will coordinate with relevant agencies to speed up the sales and settlement of debts and collaterals while other mechanisms will also continue to be implemented simultaneously.

5.3.1.2 Strengthening Loan Classification

Loan quality has always been one of the biggest issues of the banking sector as a result of high credit growth. There has been a lot of different information about the number of NPLs in Vietnam. The reason is because of the difference in loan classification between Vietnam Accounting Standard (VAS) and International Accounting Standard (IAS). According to the SBV's Decision No. 493/2005/QD-NHNN, there are five classes of debts as in the table below:

Table 2: Class of debts

(adapted from SBV's Decision No. 493/2005/QD-NHNN)

Classes	**Debts' criteria**
Class 1: Normal	Debts that are not overdue yet or overdue below 10days
Class 2: Noticed	Debts that are overdue from 10 days to below 30 days
Class3: Under standard	Debts that are overdue from 30 days to below 90 days

Class 4: Doubtful	Debts that are overdue from 90 days to below 180 days
Class 5: Possibly loss	Debts that are overdue above 180 days and debtors are not able to pay

Debts from class 3 to 5 are classified as bad debts. The majority of Vietnamese banks are now classifying their loans based on quantitative methods without considering qualitative factors like financial status and business results of enterprises, resulting in the inaccurate reflection of loan quality. The difference between Vietnam's loan calculation and International loan calculation is that Vietnamese banks only classify unpayable due amount of loan as non-performing loans while the rest amount of loan is still current loans. However, according to IAS, once a partial amount of loan is due but unpayable, the whole amount of loan will be classified as a non-performing loan. Therefore, it's the reason that international organizations' estimate of Vietnamese NPLs has always been higher than Vietnam's reports.

Moreover, some banks also take advantage of current loan classification as a way to lower their actual NPLs as rescheduled loans are not counted as NPLs. Some other banks avoid classifying their loans into group 3-5 to reduce their provision for credit losses and maintain their profit. As a result, the gap in loan classification between VAS and IAS gets bigger. However, on 21 January 2013, the SBV released Circular 02/2013/TT-NHNN (Circular 02) providing new guidelines for loan classification and loan provision standards. This new circular will replace the current Decision 493/2005/QD-NHNN and was initially expected to come into effect on June 1, 2013 for stricter regulations of bad debts.

After discussions, the implementation of the circular was postponed by one year to June 1, 2014. The delay was aimed at enabling businesses to access loans and boost credit growth in the context of the continuing economic hardships and providing credit institutions more time to prepare a roadmap and the necessary conditions to fully apply the provisions of this circular.

5.3.1.3 Initial good signals of Non – performing loans' resolution

According to the SBV's press release on NPL ratio of Vietnam's banking sector, the NPL ratio of the whole banking sector has significantly decrease to the level of 3.63 % of the total outstanding (end December, 2013) after an increase from 4.08% (end of 2012) to 4.73% in October, 2013 thanks to the improved and gradually recovered macro-economic condition together with the efforts of the system of credit institutions. Although the reduction of NPLs is not large enough, it reflects a very initial positive sign resulting from the efforts of the banking industry. However, there is still a gap between the report of the SBV and international research organizations' estimate due to the difference between rules on debt classification and risk provisioning. With numerous difficulties in production and business, slow recovery of the real estate market and the weak ability of borrowers to repay debts, the pressure on NPL resolution is very tense. The measures of debt rescheduling are very important to help enterprises get bank loans with reasonable interest rates while remaining business and the real estate market is to be improved slowly. It is hoped that, by 1 January 2015, VAMC will be able to reduce the level of NPLs at banks further and the banks will have time to either resolve their NPLs or make adequate provisioning for bad debts.

5.3.2 Resolution of bad banks and reshaping bank system

In addition to cleaning banks' bad debts, the government also aims to restructure weak banks in the sector. Vietnam's central bank aims to bring the number of commercial banks in Vietnam from over 45 at its peak to 15-20 within the next few years. There are two methods implemented in Vietnam now: merging domestic banks with one another and encouraging foreign banks to hold shares in domestic banks to expand room for foreign investors in financial and banking sector. This demonstrates that the approach of Vietnam in restructuring is relatively appropriate in comparison with international practices.

5.3.2.1 Restructuring weak banks

An important part in Vietnam central bank's plan to restructure the country's banking system is merging weak banks which faced liquidity problems. The central bank has been encouraging / forcing mergers between weak banks. After 3 years of restructuring process from 2011 to the end of 2013, there are series of mergers in the banking sector.

Table 3: Mergers of weak banks in Vietnam

Date	Old Banks	New Bank
01/2012	Saigon Commercial Bank	Merged into SCB
	Ficombank	
	Tin Nghia Bank	
01/2012	Gia Dinh Bank	Changed name into Ban Viet Commercial Bank and increase capital asset
	Tien Phong Bank	Acquired 20% stake by DOJI Group
08/2012	Saigon- Hanoi Bank	Merged

	Habubank	
9/2012	TrustBank	Restructured and signed to cooperate with 4 big banks like BIDV, Agribank, MBbank, Sacombank.
03/2013	Western Bank	Merged with Petro Vietnam Financial Corporation (PVFC) and become PVcombank
11/2013	Dai A Bank	Merged into Ho Chi Minh City Development Bank
	HD Bank	

5.3.2.2 Encouraging participation of foreign partners

Along with evaluating and identifying weak banks to take on restructuring, SBV also encourages foreign credit institutions to contribute capital ad purchase shares of Vietnam banks. Over last years, there are a number of foreign banks acquiring shares in Vietnamese banks. However, only one foreign bank is reported to have initiated discussions for the 100 percent acquisition of a weak bank[8]. Foreign banks could play an important role in the banking restructuring process in terms of (1) providing bank management, risk management and technology expertise; (2) being strategic investors with capacity of international funds raising; and (3) providing services of banking, M&A and investment in accordance with international standards.

Foreign banks currently account for about 10 percent of total assets and capital of the banking system, which is rather small compared to other countries. A higher proportion of foreign banks would increase competitiveness of the local banking market in Vietnam, improve corporate governance, banking

[8] United Overseas Bank was reported to have initiated negotiations to acquire 100 per cent of GP Bank, a small commercial bank.

technology as well as international co-operation and integration of the Vietnamese banking system.

Table 4: Foreign investors in Vietnam's banks

Name of bank	Foreign acquirer	Nationality	Ownership
Vietcombank	Mizuho Corporate Bank	Japan	15%
Vietinbank	Bank of Tokyo-Mitsubishi UFJ	Japan	20%
Eximbank	Sumitomo Financial Group	Japan	15%
Techcombank	HSBC Holdings	U.K.	20%
Vietnam International Bank	Commonwealth Bank of Australia	Australia	20%
Oricombank	BNP Paribas	France	20%
ABBank	Malayan Banking	Malaysia	20%
SeABank	Societe Generale	France	20%
Southern Bank	United Overseas Bank	Singapore	20%
ACB	Standard Chartered	U.K.	15%

Sources: company announcements; Hanoi and Hochiminh stock exchanges

The Vietnamese Government passed long awaited legislation related to foreign investment in the Vietnamese banking sector. On 3rd January 2014 it issued Decree 01/2014/ND-CP on the purchase by foreign investors of shares of Vietnamese credit institutions (Decree 01) replacing Decree 69/2007/ND-CP on the purchase by foreign investors of shareholding in Vietnamese commercial banks (Decree 69). Decree 01 became effective on 20 February 2014. The changes appear to be aimed at supporting the current strategy of the Government to attract capital into the banking sector in Vietnam.

Decree 01 is broader in scope than Decree 69, as it applies to purchases of

shares not only in Vietnamese joint-stock commercial banks, but also in Vietnamese finance companies and finance leasing companies. It does not apply to other types of credit institutions, such as joint venture banks or credit institutions established with sole shareholder ownership.

According to the new decree, a single "strategic foreign investor" will be allowed a maximum 20% of a Vietnamese bank without government approval, up from 15% as the below table. The 30% cap on total aggregate foreign ownership remains in place.

Total foreign investment in a finance company or a finance leasing company will be subject to a 49% cap, which is the limit applicable to public (both unlisted and listed) companies[9].

Decree 01 allows the Prime Minister to lift the limits on foreign shareholders' participation in a Vietnamese credit institution, but only for the purpose of (i) restructuring weak credit institutions facing difficulties; or (ii) ensuring the stability of the credit institutions system. The determination of institutions that would fall into this definition will in practice be at the discretion of the SBV or other competent authorities.

The below table provides a comparison between the new caps and the limits set out in Decree 69.

[9] The Government is apparently preparing a decree increasing this 49% cap to 60% for all public companies which will in due course increase the foreign cap in finance companies and finance leasing companies following the operation of Decree 01.

Table 5: Comparison of foreign ownership limits between

Decree 01 and Decree 69

Decree 69		**Decree 01**	
Type of Investor	***Ownership Limit***	***Type of Investor***	***Ownership Limit***
Non-credit institutional investors (inc. organisations and individual investors) and related parties	5%	Individual investors	5%
Credit institutions and related parties	10%	Organisations	15% [10]
Strategic investors and related parties	15%[11]	Strategic investors[12]	20%[13]
		Related parties cap applicable to all categories of investors	20%
Aggregate foreign ownership	30%	Aggregate foreign ownership applicable to commercial banks	30%[14]

[10] This ratio may be lifted by the Prime Minister to restructure or ensure stability of credit
institutions

[11] This ratio can be raised up to 20% with Prime Minister approval

[12] A "foreign strategic investor" is defined by Decree 01 as a foreign entity which has financial capacity and has provided a written undertaking from the competent person of the entity to ensure long term partnership with the Vietnamese credit institution and to assist the Vietnamese credit institution in modern technology transfer, developing banking products and services, raising financial, administration and management capacity.

[13] This ratio may be lifted by the Prime Minister to restructure or ensure stability of credit institutions

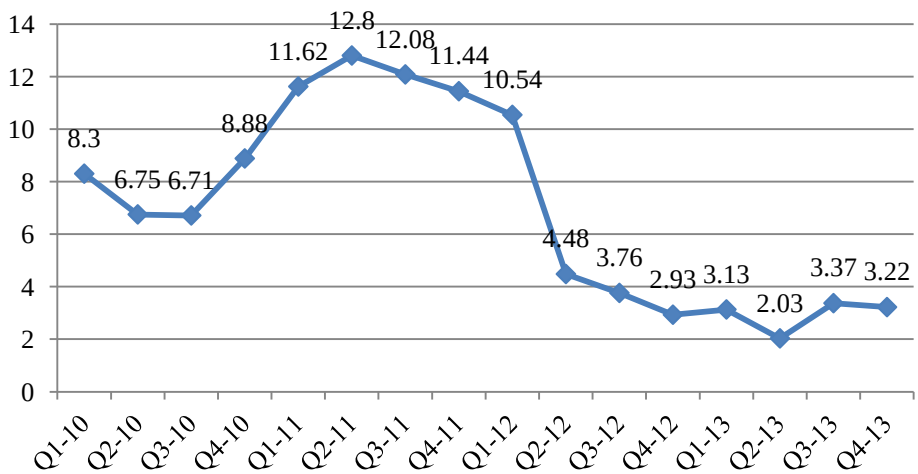
[14] This ratio may be lifted by the Prime Minister to restructure or ensure stability of credit institutions

		Aggregate foreign Ownership applicable to finance and finance leasing companies	49% [15]

5.3.3 Improving Liquidity

At the present time, the liquidity of Vietnam Banking system is considered stable by signs such as: (1) the fast rise of overnight inter-bank offered rate focusing primarily on the short-term, especially overnight transactions was temporarily appeased (Figure); (2) the considerable decrease of races among banks in raising deposit interest rates on the market; (3) no signs of decline in deposits while other investment channels are silent.

Figure 23: Inter-bank offered rate (%) 2010-2013



Source: State Bank of Vietnam

However, the liquidity of the banking system is not sustainable because: (1) the banks have not paid necessary attention to liquidity risk management.

[15] This ratio based on current regulations on foreign ownership of shares in Vietnamese public companies

According to the report of SBV (Feb, 2014), there were only 11/39 banks referring to liquidity risk issues and liquidity risk management in annual reports or financial statements; (2) the main reason leading to liquidity risk is that the imbalance term balance (the demand for the mobilization of short-term funds is high while long-term loans accounted for a large proportion) remains unresolved.

5.3.4 Renovating and improving banking supervision

One of crucial factors to any system is governance. Following Vietnam's accession into the WTO in late 2006, domestic private sectors have pushed up their growth. In the banking sector, credit institutions have also expanded their operational networks and scopes, however, banking supervision has been improved rather slowly. Therefore, it is necessary for banking sector to renovate and improve banking supervision. Banking supervision in Vietnam has mainly focused on compliance-based and administrative supervision, the capacity of risk and prudence-based supervision has remained very limited, especially the ability of analysis, assessment and warning of risks of each credit institution and the whole banking sector as well, so failing to timely, effectively and strictly deal with critical risks.

In recognition of this lack, since mid-2011, Vietnamese banking sector has focused on pointing out the problems, risks, weaknesses and violations of credit institutions. Consequently, it has discovered numerous violations and weaknesses of credit institutions in governance, internal auditing and accounting, capital mobilization, share ownership, financial revenue and expenditure, prudent vaulting, loan classification and risk provisioning, interbank operations of credit institutions. From the supervisory outcomes, the

SBV has strictly dealt with all violations, including proposals of legal proceedings. The SBV has also done its best to restructure credit institutions in line with their practical conditions and law.

Up to now, banking supervision has been renovated towards inspecting legal entities and combining compliance-based supervision with risk-based supervision. In order to meet the objectives of the annual supervision plan, banking supervision has been also guided consistently from the central to local levels. Banking supervision has mainly focused on the areas of potential risks and legal violations. Along with the banking restructuring progress, the SBV has been speeding up the formulation and improvement of legal documents. In particular, firstly, the SBV has promulgated the new regulations on loan classification and risk provisioning in operations of credit institutions towards more precise and adequate reflection of credit risks, the improvement of internal control by clarifying the responsibilities, staffing and procedures of internal control aimed at improving the internal control ability of each credit institution. Secondly, the SBV has planned to issue the specific guidelines of licensing and operational conditions of credit institutions and the regulations on expansion of the operational networks of credit institutions by tightening the licensing and operational conditions in order to improve the operational features and serve the process of restructuring the system of credit institutions. Thirdly, the SBV has been continuing to revise and issue the guidelines on professional operations of credit institutions (trustors and trustees, capital contribution and share purchase) to match the existing regulations and the development of products and services of credit institutions. Fourthly, the SBV has also been requesting the relevant authorities to promulgate a number of legal documents to create the legal

foundation to support the process of restructuring the system of credit institutions such as the regulations on special control of credit institutions, compulsory capital contribution and share purchase by those credit institutions under special control, and share purchase from Vietnamese credit institutions by foreign investors. The SBV also request the Government to revise the regulations on penalties imposed on administrative violations in the monetary and banking operations in order to heighten the responsibilities and strictness in terms of shortcomings in operations of credit institutions. Since late 2011, in a short-time, the SBV has had efforts on the renovation of banking supervision and enhancement of formulation of legal documents and the efficiency of state management of the SBV in the monetary area and improved the quality of operations and government of credit institutions as well as successfully implemented the scheme of restructuring credit institutions to make an important contribution to stabilize macro-economy and maintain the banking prudence.

VI. COMPARISON OF VIETNAM BANKING RESTRUCTURING BEFORE AND AFTER 2011

6.1 Commonalities:

Since Doi Moi Policy started in 1986 and the first banking reform initiated in 1988, Vietnamese banking sector has experienced three banking reform/ restructuring phases which contributed to improve the country's banking service and play a large role on Vietnam's socio-economic development. Although three reform/ restructuring programs was raised in different periods due to different financial and economic situations, however, these three reform/ restructuring phases basically have things in common. They were raised in effort to resolve problems Vietnamese banking system faced in each specific period in order to achieve safe operation and sustainable performance and to meet the demand for financial and banking services of national economy. They also aimed to make the system more competitive and consistent with international standards when the economy has integrated with the world.

6.2 Differences:

Each banking reform/ restructure program was raised in different periods with different economic backgrounds and the whole economy in general faced with various problems so they also required different solutions. These below tables compare differences between three banking reform/ restructure phases.

Table 6: Comparison of three reform phases

Period	First Phase 1988-1997	Second Phase 1998- 2007	Third Phase 2011-2015
Background	Open the economy to international trade and investment	After Asian financial crisis 1997 Vietnam's economic growth period to reduce development gap between Vietnam and other ASEAN countries The entry of Vietnam into WTO 2007	After global financial crisis 2008, high inefficiency in SOEs, growing bad debts and banking instability, high interest rate, massive bankruptcy in private sector.
Objectives	Create a banking system consistent with a open economy guided by market forces	Resolve effects from Asian financial crisis. Reform the system comprehensively and fundamentally for Vietnam's economic integration with the world and the implementation of WTO commitment	Resolve inherent problems of the system Improve the efficiency of the system Make the system more consistent with international standards
Results	Create a two-tiered system through the separation of the large SOCBs from the SBV The entry of JSBs and FB	Abolish the control of interest rates. The entry of 100% foreign-owned banks Restructure and recapitalize 4 large SOCBs Restructure and strengthen JSBs	Initially resolve bad debt by the establishment of VAMC and improve loan classification consistent with international standards Restructure weak

	branches		banks through M&A Increase the foreign participation by increasing shareholding of foreign investors in Vietnamese commercial banks
Limitations	Banking reform in this period was still at the initial stage Types of Financial institutions were not diverse and banking services were not diverse. Lack of banking legislation.	Need the further efforts to restructure and recapitalize the SOCBs. The reform did not mention the resolution of inherent NPLs problem.	The resolution of NPL problem was just at the initial stage and needs a high level of consensus from the government and authorities. There was little to deal with cross-ownership problem which poses a threat to the entire financial system.

VII. CONCLUSION

Banking reform/ restructuring has been a controversial and sensitive issue which has been debated for years in Vietnam. Since Doi Moi Policy in 1986, the Vietnamese banking sector has experienced three main banking reform/ restructuring phases which took place in different economic periods with different objectives set out to adapt with the solution of economic problems. The third restructuring program is the most current one. The introduction of this reform is strategically imperative to solve inherent problems Vietnamese banking sector has been facing with. Those problems are NPLs, cross-ownership etc… which caused instability in the whole economy as well as in banking sector. Therefore, adopting international standards and limiting cross-ownership are among key measures that will ensure Vietnam's banking sector reforms are effective. This is a complicated task that takes time to plan and implement. In 2011, Decision No.257 was passed to aim at achieving fundamental, comprehensive banking system restructuring by 2020. In the first phase, by 2015, the plan is to strengthen and improve the efficiency and soundness of the system of credit institutions, and to deploy market principles.

This new reform has been implemented for three years, Vietnam banking system achieved initial success: ensuring the system's liquidity, completing restructuring or merging of nine small-sized banks and establishing Vietnam Asset Management Company to partially resolve NPLs. However, this period is too short to allow a complete assessment and there will be a long way to go for the banking system. The restructuring process is facing with challenges due to a shortage of safe financial resources, an underdeveloped NPLs trading market,

lack of legal framework for foreign investors to safely enter the market, and cross ownership. State-owned commercial banks are still struggling with equitisation, and still do not function in accordance with market-based principles. Joint-stock banks are strongly affected by cross ownership, and the practices of bank management and risk management are not in compliance with international standards.

NPLs still have been an obsession for the economy without a fundamental solution approach, as there is no functional debt market. To solve NPLs, it requires a high level of consensus from the government and authorities. Implementing NPLs handling should be rushed, as NPLs would cause instability and risks for the economy. However, the scale of bad loans for the whole system requires a huge resource for resolution. The country should have more financial sources besides special bonds to handle NPLs, for example, government bonds or sale of State assets including divestment, sales of State enterprises and real estate to provide capital support for VAMC.

Bank restructuring depends on a more effective State Bank. Not only does the SBV have to be a credible and prudent regulator and formulator of monetary policy, it also has to communicate its policy stance and intentions to the public. Vietnam's financial sector shared several similarities with that in Asean and East Asia in terms of bank-based system, underdeveloped and thin bond market. Vietnam can learn many things from experience in the region. In the short-term and medium-term, the key is to restructure the banking system. In longer term, it is to have a more balanced financial system, aiming on development of a well-functioning bond market.

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국문초록

베트남 은행개혁에 관한 연구: 2011년 이전과 이후의 비교

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은행부문은 어느 경제에서나 항상 중요한 부분이다. 따라서 모든 국가들은 경제 뿐만 아니라 사회를 지탱하기 위하여 건실한 은행부문을 발전시키고 유지하기 위해 노력해야 한다. 20년이 넘는 기간 동안 급속한 성장을 경험하였지만 전반적인 베트남 경제, 특히 은행부문은 문제점 – 높은 물가상승과 저성장, 부동산부문의 호황과 침체, 정부와 정부소유기업집단의 비효율적인 투자, 부실채권과 은행의 불안정성의 증가, 높은 이자율과 민간부문의 대규모 파산 등 – 에 봉착해 있다. 이러한 시급한 문제점들을 타개하고자 베트남 정부는 2011년 'Decision 254'로 불리는 은행 구조조정 프로그램을 실시하였다.

본 연구는 베트남 은행부문의 배경과 은행부문이 직면한 문제점들을 제시한다. 이후 베트남 정부가 'Decision 254' 프로그램을 실시한 이후 은행 구조조정의 과정을 분석하고 그 결과를 이전의 은행개혁/구조조정 프로그램과 비교한다.

주요어

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