



Report and Recommendation of the President to the Board of Directors

Project Number: 42934
November 2008

Proposed Loan Saigon Thuong Tin Bank (Sacombank) (Viet Nam)

In accordance with ADB's public communications policy (PCP, 2005), this abbreviated version of the RRP excludes confidential information and ADB's assessment of project or transaction risk as well as other information referred to in paragraph 126 of the PCP.

Asian Development Bank

CURRENCY EQUIVALENTS

(as of 3 November 2008)

Currency Unit	–	dong (D)
D1.00	=	\$0.00005943
\$1.00	=	D16,825

ABBREVIATIONS

ACB	–	Asia Commercial Bank
ADB	–	Asian Development Bank
ALCO	–	asset liability committee
ANZ	–	Australia and New Zealand Banking Group Ltd.
ATM	–	automated teller machine
CAR	–	capital adequacy ratio
CEO	–	chief executive officer
CSP	–	country strategy and program
EMS	–	environmental management system
FMO	–	Financierings-Maatschappij Voor Ontwikkelingslanden
FSPL	–	Financial Sector Program Loan
GDP	–	gross domestic product
HSBC	–	Hong Kong Shanghai Bank Corporation
IDR	–	issuer default rating
IFC	–	International Finance Corporation
IMF	–	International Monetary Fund
IPO	–	initial public offering
IRR	–	internal rate of return
JSB	–	joint-stock bank
NPL	–	nonperforming loan
OECD	–	Organisation for Economic Co-operation and Development
ROA	–	return on assets
ROAA	–	return on average assets
ROAE	–	return on average equity
ROE	–	return on equity
Sacombank	–	Saigon Thuong Tin Bank
SBV	–	State Bank of Vietnam
SDPL	–	Sector Development Program Loan
SLC	–	Sacombank Leasing Company
SMEs	–	small and medium-sized enterprises
SOCB	–	state-owned commercial bank
SOE	–	state-owned enterprise
VBARD	–	Viet Nam Bank for Agriculture and Rural Development
WTO	–	World Trade Organization

NOTES

- (i) The fiscal year of the Government ends on 31 December.
- (ii) In this report, "\$" refers to US dollars.

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I. THE PROPOSAL

1. I submit for your approval the following report and recommendation for a loan of up to \$25 million to Saigon Thuong Tin Bank (Sacombank or the Borrower). Sacombank will onlend \$5 million of the loan to Sacombank Leasing Company (SLC), its leasing subsidiary, to facilitate term leases to small and medium-sized enterprises (SMEs). This is the second nonsovereign loan to the leasing sector in Viet Nam.¹

II. RATIONALE: BACKGROUND, CHALLENGES, AND OPPORTUNITIES

A. Viet Nam's Economy

1. Overview and Outlook

2. Viet Nam has maintained rapid economic growth over the past decade as the country has continued its transition from a command economy into one increasingly based on market mechanisms. The economy has grown at almost 7% per annum since 2000, with an average annual growth rate of 8% in 2003–2007 from strong export growth, foreign direct investment, and remittances—all factors that have facilitated growth in the gross domestic product (GDP) per capita from \$441 in 2002 to \$818 in 2007. GDP at purchasing power parity rose from \$1,649 to \$2,587 over this period.² Accession to the World Trade Organization (WTO) in January 2007 has further committed the country to ongoing liberalization and economic reforms as well as the sustained development of the private sector. Over the 1995–2006 period, the private sector's share of GDP rose from 14% to 23%, and its share of industrial production grew from 31% to 56%.³

3. However, in recent years, internal and external imbalances, combined with sluggish policy response, have contributed to the April–August 2008 inflationary spike. Expansionary monetary and fiscal policy fuelled credit growth, which rose to an annualized 43% in March 2008 and contributed to a rise in inflation, which reached 21.4% in April,⁴ 25.2% in May, and 26.7% in October. Other major factors contributing to inflation were the rise in international commodity prices, particularly refined petroleum, of which Viet Nam is a net importer; increased wages in the skilled labor market; escalating property prices; and the rise in domestic food prices. Food products and services account for 43% of the consumer price index; in October 2008, prices were 40.7% higher than in October 2007 because of such supply-side shocks of crop failure and livestock and poultry epidemics⁵ and consumers' hoarding of rice in April–May 2008. The Asian Development Bank (ADB) has indicated that the Government needs to maintain inflation targeting and focus on lowering the trade deficit at the expense of short-term growth. The Asian Development Outlook of ADB has revised the country's growth rate to 6.5% from 7% in 2008 and adjusted its forecast down to 6% for 2009 from the previous estimate of 8.1%.

4. In the external sector, the current account deficit widened because of ongoing large-scale investments and related capital goods imports by the public sector, higher priced commodity imports including gold, and a recent surge of precautionary imports in response to

¹ ADB's Board of Directors approved on 11 December 2007 the first nonsovereign loan, \$20 million to Vietcombank for onlending to its leasing subsidiary.

² International Monetary Fund (IMF). *World Economic Outlook*. 2007. Washington, DC.

³ ADB. 2006. *Viet Nam: Country Strategy and Program 2007–2010*. Manila.

⁴ IMF. *May 2008 Survey*. Viet Nam's New Challenges amid Overheating.

⁵ ADB. 2008. Viet Nam Country Chapter. *Asian Development Outlook 2008 Update*. Manila (17 September).

the Government's announcement of import taxes on cars and motorcycles.⁶ Despite strong exports, the external current account deficit moved from 9.6% of GDP in 2007 to an estimated 25% of GDP in January–June 2008. Overall, investor sentiment remained mostly positive as indicated by net foreign direct investment inflows, which reached \$6.6 billion in 2007 and are estimated at \$5 billion for the first 6 months of 2008. Thus, the overall balance of payments reached a surplus in 2007 and a small deficit in the first 6 months of 2008. As a result of foreign direct investment inflows and a rise in portfolio investment, official reserves have increased from \$11.5 billion at end-2006 to an estimated \$21 billion at end-2007, standing at an estimated \$20 billion as of end-June 2008.

5. Concerns over the recent inflationary spike resulted in the downgrading by Fitch Ratings in May 2008 of Viet Nam's country outlook from stable to negative. The rating agency has indicated that the Government's response has been both too slow, with official positions not followed up by immediate action, and too small, with real interest rates remaining negative following the recent increase. Fitch notes, however, that the authorities have recently become more willing to take action to urgently control inflation and strengthen market-oriented macro-management tools. This includes a tighter monitoring policy, strict regulations on bank capital adequacy with a ceiling on bank lending growth of 30% year on year, and a move toward widening the daily trading band from 0.75% to 1.00% in March 2008 with flexibility up to 2.00% in June 2008. As a result of these measures, money supply (M2) slowed to an annualized rate of 19.0% in September 2008, from 46.1% in 2007. The credit growth rate in the banking system was estimated at 37.0% over the same period. The Government has also tightened fiscal policy by improving tax collection and suspending or cancelling an estimated \$2.1 billion in state-owned enterprise (SOE) projects in the second quarter of 2008. Thus the fiscal balance moved from a deficit of 5.5% of GDP in 2007 to a surplus of 0.4% of GDP in first half of 2008.

6. Overall, Fitch has affirmed Viet Nam's sovereign rating of BB minus, its BB minus long-term foreign currency issuer default rating (IDR) and its BB long-term local currency IDR. Fitch has affirmed its short-term foreign currency IDR at B. Standard and Poor's sovereign rating for Viet Nam is BB, while Moody's has assigned a Ba2 rating. All rating agencies have downgraded their outlook to negative pending further progress on inflation targeting by the Government.

2. Challenges for the Future

7. Viet Nam will need to address the major challenges of continuing structural transition toward a market-based economy, successful macroeconomic management in the medium-term to sustain growth, and improving the coordination and transparency of policy response with respect to controlling inflation.

8. The International Monetary Fund (IMF) recently outlined a package of four policy initiatives for Viet Nam to maintain investor confidence and restore macroeconomic stability. These are (i) further tightening of monetary policy to bring credit growth and inflation under control (i.e., make more effective use of interest rate policy to support positive real interest rates without disrupting financial intermediation in the banking system, as well as improved oversight of the banking system); (ii) improved budgetary control of expenditure and borrowing by SOEs with future investments restricted to core areas of SOE business; (iii) revised fiscal plans for 2008, including restrained budgetary expenditure and cutbacks in off-budget investments; and

⁶ ADB. 2008. Viet Nam Country Chapter. *Asian Development Outlook 2008 Update*. Manila (17 September). The volume of imports of cars, motorcycles, steel, urea, paper, and cotton increased by 30–414% over the January–August 2008 period from December 2007. The trade deficit widened to \$14.8 billion in the first 6 months of 2008.

(iv) greater exchange rate flexibility to simplify monetary management and assist the State Bank of Vietnam (SBV) to better manage shifts in capital flows.⁷ The IMF encouraged further independence for SBV and the ongoing equitization of SOEs and state-owned commercial banks (SOCBs) as a means of improving corporate governance.

9. There are some indications that the macroeconomic situation has started to improve as a result of coordinated Government measures. Capital has started moving back into dong-denominated assets, bank deposits in dong have increased, and interest rates declined in July and August 2008. As a result, the yield on the 5-year Government bond moved to 17% in mid-August, after rising to about 20% in mid-June from less than 9% in early April. The Viet Nam index in the Ho Chi Minh City stock exchange strengthened to over 500 in August 2008 from 366 in June, which represented a 60% loss in value from October 2007 (footnote 5).

B. The Banking Sector in Viet Nam

1. Overview

10. The 5-year socioeconomic development plan for 2006–2010 states that, in the area of banking and finance, the Government will “gradually abolish all preferences enjoyed by the state-owned commercial banks, and stop the interference of the SBV in the business of commercial banks.”⁸ SBV acts as a central bank and supervisory institution but is also a shareholder in SOCBs. The Government has drawn up a road map of future banking reforms to address such institutional needs and has promoted a greater role for market mechanisms through equitizing SOCBs and opening the sector to foreign banks. With respect to compliance with international standards, Basel I standards⁹ are currently in place, and SBV aims to implement Basel II standards by 2010.

11. At present, the Government’s primary concern is to fight inflation while ensuring steady growth in bank lending operations on the basis of more stringent guidelines. In this respect, SBV introduced the following monetary policy measures in the first quarter of 2008: (i) an increase in bank reserve requirements from 5% to 11% of dong and foreign currency deposits with tenors of less than 12 months, effective from June 2007; (ii) the sale of D20.3 trillion (\$1.3 billion) in 1-year dong-denominated SBV bills to commercial banks to mop up excess liquidity; (iii) an increase in the base rate by 325 basis points to 12% in May 2008 and to 14% in June 2008 (the new effective maximum lending and deposit rates are officially reported to have been 1.5 times SBV’s prime rate, i.e., 18%, in May 2008 and 19.5% in September 2008, though deposit rates vary across the banks); and (iv) an increase in its refinancing rate to 15% in June 2008 from 7.5% in February 2008 and in its discount rate to 13% from 6.5% over the same period. To guard against losses in the speculative stock market, SBV took measures in early 2007 to slow and discontinue bank lending to securities company subsidiaries by raising the risk weight for securities-related loans to 250% from 100%; the maximum threshold for securities lending is 20% of chartered capital, based on Decision 03/2008/Qd-NHNN of 1 February 2008. More recently, in response to tightening international credit flows, SBV has requested SOCBs to support enterprise access to credit by adjusting their lending rates. As of October 2008, SOCB lending rates are 18.5% and in exceptional circumstances, range from 16.2% to 17.2%, below

⁷ IMF. 2008. *Viet Nam: Informal Mid-Year Consultative Group Meeting*. Lao Cai. (5–6 June).

⁸ Ministry of Planning and Investment, Viet Nam. 2006. *The Five Year Socio Economic Development Plan 2006–2010*. Hanoi (page 77).

⁹ Basel I standards established the minimum capital requirements for banks when issued in 1988 by the Bank for International Settlements. Basel II standards, which are considered to be more comprehensive, are in the process of being implemented by several countries. Viet Nam has not yet implemented Basel II standards.

the earlier SBV established ceiling of 19.5%. Lending rates offered by the JSBs are also occasionally lower than the ceiling.

12. As per SBV's Decision No. 13/2008/QD-NHNN of 29 April 2008, promulgating the regulation on the operation networks of commercial banks, SBV restricted growth in bank operations, i.e. opening of new branches, through tighter conditions placed on bank financial capital. Prime Minister Nguyen Tan Dung also ordered SBV to cap credit growth at 30 per cent per year. This measure was introduced to slow loan growth and guard against nonperforming loans (NPLs) in some joint-stock banks (JSBs), where loan books grew by over 100% over 2006–2007. Total bank loans grew by 53% in 2007, though SOCBs have maintained the most conservative approach to loan portfolio growth (24% in 2007) to focus on improving capitalization and loan book quality in preparation for equitization. The smaller JSBs are the most exposed in terms of asset–liability mismatch and property market portfolio concentration, and they will likely come under pressure to either declare bankruptcy or merge with a larger bank during 2008.

2. Performance

13. The banking sector has grown significantly since the adoption of the Law on Credit Institutions in 1997 (Decree 02-1997-QH10, dated 12 December 1997), which allowed a variety of products to be offered by credit institutions and introduced prudential provisions including capital norms, restrictions on asset and liability management, deposit insurance, and limits on credit institutions' investments in real estate. The number of banks increased significantly over the past decade as a result of SBV deregulation. The number of registered banks is high, with 5 joint venture banks, 36 private banks, 44 foreign bank branches, and 55 foreign bank representative offices. While the banking system is still characterized by the strong presence of the 4 SOCBs, JSBs are slowly gaining market share. Other state banks include the Vietnam Commercial Bank, Vietnam Development Bank and Vietnam Bank for Social Policies.

14. With respect to the recent medium-term outlook, Fitch's Viet Nam bank report on 29 May 2008 indicates that strong economic growth has provided significant expansion opportunities for the commercial banks in Viet Nam and that, furthermore, low penetration overall—with less than 5% of the population regularly using banking services and 10–20% holding bank accounts—provides good opportunities for growth in the banking sector in the medium-to-long term. In particular, Fitch indicates that large private banks that, like Sacombank, have a major international bank as a strategic investor stand to gain from their more commercially oriented and improved risk-based banking operations. Loan growth for the large private commercial banks, including Sacombank, has generally been in trade, manufacturing, and well-secured mortgages with relatively low exposure in the speculative property development market. Sacombank indicates prudent portfolio expansion.

15. With their recent expansion, private banks are undermining the market dominance of the SOCBs, particularly in the retail sector. In terms of market structure, the four major SOCBs accounted for 50% of total loans at end-2007, down from 62% at end-2006. The five larger urban JSBs,¹⁰ each with a major international bank as a minority strategic foreign investor, currently account for over 20% of market share, followed by 19 smaller banks and 12 small, rural JSBs.

¹⁰ Sacombank, Techcombank, Viet Nam International Bank, Asia Commercial Bank, and East Asia Commercial Bank.

16. According to Fitch, there are no expected domestic liquidity concerns for SOCBs, as their deposit franchises are strong and their deposit funding stands to benefit during a flight to quality. In 2007, deposit growth held up well at around 22% on average to support loan growth. Depositors are, however, monitoring the benefits of purchasing gold versus maintaining savings in interest-bearing accounts. NPLs have declined, but overall asset quality is inferior to that of the private banks, though some SOCBs that are preparing for equitization, including Vietcombank, have taken specific measures to improve loan quality and recognize nonperforming assets. Table 1 provides a brief review of SOCB performance and related Fitch rating.

Table 1: Key Financial Ratios, State-Owned Commercial Banks

Item	Vietnam Bank for Agriculture and Development (D/E)		Bank for Investment and Development (D/E)		Bank for Foreign Trade (D)		Industrial and Commercial Bank (D/E)	
	Sep 2007	Sep 2006	2007	2006	2007	2006	2007	2006
	Assets (\$ million)	18,090.0	15,704.0	12,518.0	9,852.0	12,274.0	10,443.0	10,660.0
Equity (\$ million)	1,099.0	698.0	543.0	276.0	698.0	625.0	682.0	349.0
ROAE	30.2	11.8	24.4	14.2	20.6	25.7	14.1	10.8
ROAA	1.6	0.5	0.9	0.4	1.2	1.5	0.8	0.5
Net Interest Margin	3.4	4.1	2.7	2.4	2.4	2.3	3.4	3.2
Equity Total Assets	6.1	4.4	4.3	2.8	5.7	6.0	6.4	4.1
Equity/Loans	8.5	5.9	7.0	4.7	11.9	15.3	11.0	7.0
Loans/Deposits	87.0	97.0	79.0	71.0	48.0	41.0	82.0	76.0
Loan Growth	12.0	18.0	34.0	18.0	44.0	10.0	25.0	8.0

BIDV= Bank for Investment and Development, IFRS=International Financial Reporting Standards, ROAA = return on average assets, ROAE = return on average equity.

Note: Individual ratings shown in brackets. IFRS: BIDV and Vietcombank (preliminary, 2006 ratios based on actual fiscal year 2006 data instead of averages).

Sources: Bank financial statements reclassified by Fitch, May 2008.

17. The balance sheets of the larger joint-stock commercial banks look healthy overall. These banks are considered to have a sufficiently strong deposit franchise to ensure continued liquidity. The recent Fitch banking report indicates that, in general, capitalization appears satisfactory, with equity/loans ratios ranging from 13% to 21%. In 2007, loan growth was supported by deposit growth, thus maintaining liquidity balance. Table 2 provides a brief overview of large private bank performance and related Fitch rating. (See Appendix 1 for State Bank of Viet Nam provision guidelines).

Table 2: Key Financial Ratios, Joint-Stock Banks

Item	Asia Commercial Bank ('D')		Saigon Thuong Tin CJSB ('D')		Technological & Commercial Join- Stock Bank ('D')		International Bank ('D')	
	2007	2006	2007	2006	2007	2006	2007	2006
Assets (\$ million)	5,308.0	2,781.0	4,014.0	1,543.0	2,457.0	1,072.0	2,443.0	1,029.0
Equity (\$ million)	389.0	106.1	457.0	179.0	230.0	105.0	136.0	74.0
ROAE	44.3	33.9	27.4	19.8	24.4	15.3	18.3	16.4
ROAA	2.7	1.5	3.1	2.4	2.3	1.5	1.1	1.2
Net Interest Margin	2.0	2.4	2.6	3.5	3.3	3.3	2.5	3.0
Equity/Total Assets	7.3	3.8	11.4	11.6	9.4	9.8	5.6	7.2
Equity/Loans	19.8	10.0	20.9	20.1	18.7	19.5	13.1	13.1
Loans/Deposits	45.0	45.0	65.0	68.0	60.0	59.0	56.0	61.0
Loan Growth	87.0	81.0	146.0	71.0	130.0	64.0	82.0	73.0

ROAA = return on average assets, ROAE = return on average equity.

Sources: Bank financial statements reclassified by Fitch, May 2008.

18. **Banking Sector Competition.** Viet Nam's recent accession to WTO, which allows foreign banks to set up wholly owned foreign subsidiaries, is expected to increase competition in the banking sector. It is reported that SBV expects to receive around 20 new applications for banks from large corporations and seven foreign banks. Among the applicants are Standard Chartered Bank and banks from Taipei, China and the Republic of Korea. Australia and New Zealand Banking Group Ltd. (ANZ), Hong Kong Shanghai Bank Corporation (HSBC), Standard Chartered, and Overseas-Chinese Banking Corporation Limited have all purchased interests in local banks. In 2008, Standard Chartered, HSBC, and ANZ became the first foreign banks permitted to found their wholly owned corporations in Viet Nam.¹¹

19. The nonbank financial intermediaries sector and institutional investors, other than the insurance sector, are insignificant. The market for primary government debt is quite rudimentary, while the secondary government debt and corporate debt markets are highly illiquid and underdeveloped. The absence of well-developed debt markets is a constraint on the ability of leasing companies to raise longer-term funds.¹² The equities market, though small and still developing, has shown significant growth as well as market correction. Total company listings at the country's two stock-trading centers increased fourfold, from 44 to 193, between end-2005 and end-2006, and during the same period total market capitalization increased by almost 21 times, from D11 trillion to D231 trillion, or to 25% of GDP in 2006, compared with 1.3% at end-2005. Market capitalization reached D494.5 trillion in 2007 (or 43.4% of GDP). However, concerns over the value of securities in the January–June 2008 inflationary environment led to divestment from the stock market into other forms of capital and gold, as well as to market correction in terms of the stock/price earnings ratio. Consequently, the total capitalization of Viet Nam's two bourses in Hanoi and Ho Chi Minh City is estimated to amount to D294.5 trillion as of September 2008, or approximately 25.8% of the country's GDP as of September 2008, half of the market value recorded in 2007.

¹¹ Each bank is required to have charter capital of at least D1 trillion (\$620 million).

¹² As also indicated in ADB. 2007. *Report and Recommendation of the President to the Board of Directors on a Proposed Program Cluster and Loan to the Socialist Republic of Viet Nam for the Third Financial Sector Program (Subprogram 1)*. Manila (Loan 2377-VIE, for \$75 million, approved on 6 December).

20. **Bank Capitalization.** Both the fall in value of the Ho Chi Minh City stock exchange, where market value fell 30% over October 2007–August 2008, and the recent inflationary spike place constraints on Vietnamese banks' ability to raise capital. Consumers are placing their investments in traditionally secure investments, such as gold, and are at present reluctant to invest in stocks. Recent uncertainties have contributed to some JSBs' reconsidering the issuance of a bond to assist with tier II capital. Until the inflationary situation stabilizes and consumer confidence in securities is restored, few banks are expected to issue a domestic initial public offering, rights issue, or bond. IMF Article 4 consultation meetings in Viet Nam are expected to be concluded in October 2008 and the report issued in December 2008. IMF will likely continue to draw attention to targeting inflation, uneven progress in SOCB and SOE reform, and the need for SBV independence.

21. **Equitization of State-Owned Commercial Banks.** To improve the competitiveness of the financial sector and comply with WTO accession requirements with respect to opening the financial services market, the Government announced equitization plans for all five SOCBs in 2005.¹³ The Government has indicated it will retain a majority share of 51% in most SOCBs over the medium-to-long term. At present, up to 30% of the shares in each major SOCB may be sold to the public and foreign strategic partners. To support the restructuring of the banking sector, the World Bank began implementing its Banking Sector Reform Program (2002–2015) with the following activities: (i) restructuring SOCBs, (ii) restructuring non-state (joint-stock) banks, (iii) improving the prudential regulatory and supervisory framework, and (iv) leveling the playing field for all banks.

22. Among SOCBs, Vietcombank was the first to initiate transition into a JSB through the domestic sale of 6.5% of its shares in December 2007. Approximately 3.5% of the shares were sold to bank employees, with the remainder sold to national institutional investors. Any further initial public offering, domestic or international, is being deferred until consumer and investor confidence in emerging market stocks is restored.

23. **Joint-Stock Banks.** The top five urban banks—Techcombank, Sacombank, Viet Nam International Bank, Asia Commercial Bank, and East Asia Commercial Bank—all have minority international strategic investors. The smaller urban JSB group consists of banks such as Habu Bank, Viet A Bank, and Saigon Bank.

24. The major JSBs have launched ambitious expansion plans. Over the past 4 years, Sacombank, Asia Commercial Bank (ACB), and Techcombank have expanded their branch networks, with each reaching close to 200 bank branches including sub-branches and transaction centers. The rapid growth in the retail and SME markets was curtailed by the Government in early 2008 with the introduction of the 30% cap on further credit expansion and increased monitoring with respect to overall banking sector provisioning. All the major banks are audited by accredited accounting firms.

25. Loan growth for the large private commercial banks, including Sacombank, has generally been in trade, manufacturing, and well-secured mortgages. While the specific impact of the fall in property prices needs to be assessed case by case for each major bank, project due diligence of Sacombank indicates prudent portfolio expansion and appropriate provisioning

¹³ The Government has committed to equitizing Vietcombank and Mekong Housing Bank in 2007, Industrial and Commercial Bank of Viet Nam (Incombank) and Bank for Investment and Development of Viet Nam (BIDV) in 2008, and Viet Nam Bank for Agricultural and Rural Development in 2009.

and mechanisms for monitoring credit risk, both at the head office and in branches.

26. **Potential for Growth.** Opportunity for growth in the retail and SME markets is strong across the banking sector. Overall penetration is low, as less than 5% of Viet Nam's total population of about 85 million regularly uses banking services and between 10% (according to International Financing Review Asia) and 20% (McKinsey) has bank accounts. Among the urban middle class of 8 million, defined as those with a monthly income of at least \$500, only 22% have bank accounts. The average loan is for \$3,000, and, while the most common credit product is a car loan, new car sales have so far not exceeded 6,000 units per month. Loans to SMEs tend to be in the range of D1 billion–D2 billion (\$62,000–\$124,000) for short maturities and are highly secured. It is reported¹⁴ that access is very limited to loans of over D5 billion (\$312,000) or to medium- and long-term loans. Large private banks like Sacombank with a major international bank as a strategic investor stand to gain from their more commercially oriented and improved risk-based banking operations.

C. SME and Leasing Sector Background

1. Constraints to SME Development: Lack of Access to Financing

27. SMEs play a significant role in the economy of Viet Nam and are the major source of employment. The country strategy and program (CSP) 2007–2010 for Viet Nam indicates that over 165,000 enterprises have been registered under the 1999 Enterprise Law¹⁵ since its enactment in 2000 and that over 90% of these registered enterprises are SMEs with registered capital of less than D10 billion (\$625,000) and fewer than 300 employees. The CSP further states that “the private sector now generates over 60% of GDP and employs 90% of the total workforce. Rapid private sector development has been a key element of Viet Nam's pro-poor socioeconomic development. The domestic private sector generates more employment and output per unit of investment than either the state sector or foreign investors.”¹⁶

28. To maintain enterprise growth, particularly during current inflationary trends, access to finance needs to be facilitated and improved. The 2005 World Bank investment climate survey¹⁷ indicates access to finance to be a more significant constraint to enterprises in Viet Nam than elsewhere.

¹⁴ Ministry of Planning and Investment, Enterprise Development Department. 2007. Hanoi.

¹⁵ A new enterprise law unifies the options available to both domestic and foreign investors wanting to establish companies in Viet Nam. The law took effect on 1 July 2006 and repeals the 1999 Enterprise Law, which was applicable mostly to domestic investors, the Law on State-Owned Enterprises, and relevant parts of the Law on Foreign Investment in Viet Nam.

¹⁶ ADB. 2006. *Viet Nam: Country Strategy and Program 2007–2010*. Manila (paras. 31–32).

¹⁷ Smith Warrick. 2004. *World Development Report 2005: A Better Investment Climate for Everyone*. Washington, DC: World Bank.

Table 3: Major Binding Constraints on Business Investment in Viet Nam and Elsewhere

Constraint	East Asia	Viet Nam	The World
Access to finance	17.4 ^a	37.4	30.1 ^a
Access to land	9.9 ^a	26.4	14.5 ^a
Labor skills and education	23.8	22.3	20.4 ^b
Transportation	15.2 ^a	21.6	12.4 ^a
Cost of finance	20.2	21.3	36.1
Macroeconomic instability	34.1 ^a	16.8	40.2 ^a
Electricity	24.4 ^a	15.7	24.4 ^a
Policy uncertainty	32.5 ^a	14.7	40.2 ^a
Tax rates	28.2 ^a	13.8	40.5 ^a
Corruption	28.6 ^a	12.8	36.8 ^a

^a Statistically significantly different from Viet Nam at the 99% confidence level.

^b Statistically significantly different from Viet Nam at the 90% confidence level.

Figures are the percentage of firms that consider the constraint either severe or major. East Asia comprises observations from Cambodia, People's Republic of China, Indonesia, Malaysia, Philippines, and Thailand. Sources: Viet Nam Development Report 2005 page 43. Data from World Bank investment climate survey database, using unweighted averages.

Source: Viet Nam: Country Strategy and Program 2007–2010.

29. SMEs in Viet Nam have difficulty accessing financial services and securing financing, mainly because of the strong risk-averse bias of banks with respect to SME lending. This perception is slowly changing, as some of the major JSBs and SOCBs begin to tailor credit instruments to meet the needs of larger SMEs. Also, some commercial banks, such as Sacombank, have developed and implemented a financial strategy focused on penetrating the expanding SME customer base in Viet Nam.

2. Nascent Leasing Industry

30. From a developmental perspective, leasing is of particular importance for its role in financing SMEs that do not have either the capital to purchase equipment or the collateral to access conventional sources of funds. An ADB survey of SMEs in Viet Nam, conducted during technical assistance in 2007,¹⁸ identified the following benefits of leasing: (i) leasing companies require less collateral than banks, as the asset being financed is the security; (ii) they are more aggressive with respect to expanding the SME client base; and (iii) leasing allows for complementary financing through commercial bank credit lines. Most SMEs indicated their business growth depends on continued access to lease financing for manufacturing equipment to fill both domestic and export orders. At present, the average loan to a customer from a leasing company is \$88,000, and the average equity of the leasing company's SME client base is \$170,000. The leasing industry has expanded by 15–20% per year and focuses mostly on two sectors: (i) transport and automobiles and (ii) industrial machinery and equipment.

31. However, the leasing industry remains small. The total assets of the nonbanking sector are estimated to be less than 3% of total bank assets.¹⁹ The leasing industry, with total assets of D13.0 trillion (\$814 million), accounts for 1.24% of the formal financial sector.²⁰

¹⁸ ADB. 2006. *Technical Assistance to the Socialist Republic of Viet Nam for Small and Medium-Sized Enterprise Development Program—Subprogram II*. Manila (TA 4781-VIE, for \$600,000, approved on 20 April).

¹⁹ In Viet Nam, the nonbank financial sector includes leasing, insurance, and the securities market.

²⁰ Viet Nam Leasing Association.

32. **Policy Reforms in the Leasing Sector.** Leasing industry analyses undertaken during ADB's Financial Sector Program Loan (FSPL II) and SME Sector Development Program Loan (SDPL)²¹ revealed that the funding gap in the leasing industry and regulatory constraints were the major causes for the industry's slow growth. Accordingly, the Government undertook a series of policy reforms under the FSPL II and the SDPL to assist the development of the leasing sector. Leasing companies are licensed and regulated by SBV and regarded as nonbank credit institutions under the Law on Credit Institutions. SBV's Decree 16/2001 ND/-CP of 2 May 2001 provided the broad legal framework for leasing operations. The decree authorizes only those financial leasing companies licensed by SBV to undertake finance leasing transactions. The activities of leasing companies were initially restricted to financial leasing for machinery, equipment, vehicles, other moveable assets, and other services related to financial leasing operations. The Government issued Decree 65/2005/ND-CP of 19 May 2005 to amend Decree 16, allowing for operating leasing, the sale of finance lease receivables and lease back, and syndicated lease transactions. Decree 65 provides for a limit of exposure to a single client equal to 30% of all capital of a finance leasing company and outlines the broad procedures for enforcing leasing contracts. Under the technical assistance (TA) for the Small and Medium-Sized Enterprise Development Program, implemented over the period March–October 2007,²² ADB trained leasing companies on upgrading lease agreements to clarify lessor and lessee commercial obligations and mitigate the risk of repossession. Constraints remain in the area of interministerial coordination on repossession, in particular among the commercial court, Ministry of Justice, and Economic Police. ADB is maintaining dialogue with the Government on this issue under FSPL III, approved in 2007.

33. **Use of Self Help.** To facilitate the use of self help by leasing companies, ADB undertook a series of consultations with the industry and the Government in 2007. TA 4781 consultations led to the Government's issuing Circular No.08/2007/TT-NHNN-BCA-BTP dated 12 October 2007, *Guidelines on Repossession and Settlement of Leasing Assets of Leasing Company*. The circular clarifies the rights of the leasing company to the recovery of assets through the use of self help and the timeline and provides clear guidelines on the scope of involvement by Government ministries and people's committees in this area.

34. Leasing companies have introduced the following measures to reduce the risks and costs of repossession: (i) upgrading lease agreements to ensure both lessor and lessee are equally aware of obligations under the contract and knowledgeable about the use of self help and recourse to power of attorney, (ii) improved integration and association with suppliers to assist in valuating the item to be repossessed and its resale, (iii) restricting the financing of one-off assets used by a very limited number of companies, and (iv) specializing leasing officers in specific industries and equipment. Other measures introduced include improved marketing campaigns and organization of workflow, specifically the separation of active from nonperforming accounts into specialized units, as well as improved performance measures.

²¹ ADB. 2004. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Socialist Republic of Viet Nam for the Second Financial Sector Program (Subprogram 2)*. (Manila. Loan 2118-VIE, for \$35 million, approved on 3 December); and ADB. 2004. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Socialist Republic of Viet Nam for the Small and Medium-Sized Enterprise Development Program (Subprogram 1)*. Manila (Loan 2095-VIE, for \$60 million, approved on 21 October).

²² ADB. 2006. *Technical Assistance to the Socialist Republic of Viet Nam for Small and Medium-Sized Enterprise Development Program–Subprogram II*. Manila (TA 4781-VIE, for \$600,000, approved on 20 April, Leasing Investment Loan Component).

35. **Cap on Parent Bank Funding.** To mitigate inflationary pressures, SBV issued Decision 03/2007/QD-NHNN on 19 January 2007 to amend Decision 457/2005/QD-NHNN regulating the safety ratios of credit institutions' operations. Decision 3 places a cap equivalent to 10% of parent bank equity on parent bank funding to subsidiary companies, including leasing companies, and requires relending to be extended at commercial interbank rates. There have been no amendments to Decision 03 in 2008.

36. **Market Assessment.** Indications are that regulatory reforms have promoted the growth of the leasing sector in Viet Nam, which nearly doubled over the period 2005–2007. Over this period, outstanding leases grew from an estimated \$374 million to \$710 million; they stood at \$814 million in June 2008. Leasing companies indicated they estimate growth rates of 20–30% year on year, with ongoing strong demand from SMEs for automobiles and industrial machinery.

37. **Funding Gap.** Leasing industry analyses undertaken during the FSPL II and the SDPL revealed that the funding gap in the leasing industry and regulatory constraints were the major causes for the industry's slow growth. Leasing company funding is exclusively through borrowings from the parent bank. Access to short-term customer deposit funds from the parent bank (under 360 days at floating 90–180 day rates) and, in the case of some leasing companies, from customer deposits (under 13 months), is creating a funding mismatch with respect to medium- and long-term leases issued by leasing companies in response to customer demand.

38. **Market Structure.** There are 13 leasing companies in Viet Nam, categorized under Decree 16 as state run (seven), affiliate (four), and joint venture (two), with no companies currently in the joint-stock category.

Table 4: Leasing Sector Overview, end-2006

Company	Shareholders
Affiliate Financial Leasing Companies of Credit Institutions	
Kexim Leasing Company	
Chailease International Leasing Company	Chailease Finance Co. Ltd Taipei, China 100%
Sacombank Leasing	Sacombank 100%
Asia Commercial Bank Leasing	ACB 100%
Joint-Venture Financial Leasing Companies	
ANZ/V-TRAC Leasing	ANZ Bank, Caterpillar Equipment
Viet Nam International Leasing Company	Industrial & Commercial Bank of Viet Nam, Natexis, KDB Capital Corporation, Aozora Bank
State-Run Financial Leasing Companies	
Vietcombank Financial Leasing Company	Vietcombank
Industrial and Commercial Bank of Viet Nam Leasing Company	Industrial and Commercial Bank of Viet Nam
Viet Nam Bank For Agriculture and Rural Development Financial Leasing Co I	Viet Nam Bank For Agriculture and Rural Development
Viet Nam Bank For Agriculture and Rural Development Financial Leasing Co II	
Bank for Investment and Development of Viet Nam Financial Leasing Co I	Bank for Investment and Development of Viet Nam
Bank for Investment and Development of Viet Nam Financial Leasing Co II	
Vinashin Leasing	Viet Nam Shipbuilding Industry Corporation (Vinashin)

Source: Viet Nam Leasing Association.

39. The two leasing subsidiaries of the Viet Nam Bank for Agriculture and Rural Development (VBARD)²³ and the two leasing subsidiaries of Bank for Investment and Development of Viet Nam together account for over 60% of market share. The other public leasing companies in the SOCBs of Viet Nam include Vietcombank Financial Leasing Company and the leasing subsidiary of Incombank. These leasing companies and the six privately held leasing companies—Viet Nam International Leasing Company, Sacombank Leasing Company, KEXIM Viet Nam Leasing Company, ANZ/V-TRAC, Chailease International Leasing Company, and the recently formed subsidiaries ACB Leasing Company (part of ACB) and Vinashin Leasing Company (part of Vinashin)—share the remaining 40% of the market.²⁴ It is expected the foreign-invested JSBs will continue to aggressively develop their leasing facilities to participate in the growing market.

Table 5: Leasing Market Share, June 2008

Companies	Market Share (%)
ANZ	0.15
VBARD I	10.0
VBARD II	40.0
BIDV II	8.0
KEXIM	7.0
BIDV I	13.0
INCOMBANK	7.0
VIETCOMBANK	7.0
SACOMBANK	2.0
VILC	4.0
CHAILEASE	2.0
ACBL	0.28
VINASHIN	
	100.0
	(\$814 million outstanding leases)

ANZ = Australia and New Zealand Banking Group Ltd., BIDV = Bank for Investment and Development of Viet Nam, KEXIM = Export-Import Bank of Korea, VBARD = Viet Nam Bank for Agricultural Development, VILC = Viet Nam International Leasing Company, ACBL= Asia Commercial Bank Leasing.

Source: Viet Nam Leasing Association.

III. THE BORROWER

A. Background

40. Sacombank, headquartered in Ho Chi Minh City, commenced its operations in December 1991. It was the first bank to list on the Ho Chi Minh City stock exchange in 2006, where it is the largest listed firm. The bank is the fifth largest by registered capital and the sixth

²³ VBARD II undertakes the leasing of ships, hence the company's large market share in terms of total outstanding leases.

²⁴ IFC recently divested itself of the Viet Nam International Leasing Company, a joint equity investment with Incombank, Natexis, KDB Capital Corporation, and Aozora Bank, to review potential activities in the sale of lease receivables and has taken equity participation in Sacombank. Sacombank formed its leasing company in 2006. The third private leasing company, ANZ/V-TRAC, is owned mainly by ANZ, with Caterpillar holding a minority share. The fourth, KEXIM Viet Nam Leasing Co., is the subsidiary of the Korea Export Import Bank. Chailease is a subsidiary of Chailease Finance Company Limited of Taipei, China.

largest by assets, with a 5% market share by asset size in December 2007. Sacombank has three strategic foreign shareholders: ANZ, IFC, and Dragon Capital. Financial statements for 2006 and 2007 have been audited by PricewaterhouseCoopers, with the most recent auditor's report in December 2007 providing comments on financial statements based on Viet Nam accounting standards. Accounting statements as per international financial reporting standards are made available to ADB's Board of Directors. Retail banking is conducted through a network of 238 branches and transaction offices nationwide. The bank opened a representative office in Nanning, People's Republic of China, in January 2008 and is scheduled to open a branch in the Lao People's Democratic Republic in late 2008 and in Cambodia in 2009. Sacombank employed 5,470 staff at the end of 2007. Total assets reached D63.3 trillion (\$3.9 billion) and equity amounted to D4.4 trillion (\$275 million) in December 2007.

41. Sacombank offers a full range of banking services, including deposit taking in dong and foreign currencies (primarily US dollars), lending, trade finance, guarantees, treasury services, and credit card and payment services across all market segments. Sacombank is primarily an SME bank, as over 60% of its loans are to SMEs. The bank aims to further improve its service to SMEs by expanding the provision of financial leases across 30 major branches in Viet Nam in 2008. By offering the complementary service of SME working capital and factoring together with medium-term financial leases, the bank looks to deepen its penetration of the SME market and create the opportunity to attract firms with smaller equity bases to grow within the integrated Sacombank SME financial services program. To comply with internal and national prudential regulations, Sacombank has indicated that the branch-based lease financing program will be guided by the bank's internal risk-management procedures strictly administered and monitored at the branch level.

IV. THE PROPOSED LOAN

A. ADB Loan

42. ADB identified the loan further to policy dialogue undertaken with the Government under FSPL II and SDPL. The policy programs highlighted the constraints on SMEs' access to finance and addressed upgrading the legal and regulatory framework to facilitate the development of the leasing industry. In 2007, during TA 4781 implementation, all leasing companies received comprehensive training on risk management, risk pricing, and marketing lease products. ADB undertook due diligence of all major leasing companies and their parent banks in Viet Nam and upgraded regulations referring to self help.²⁵ See Appendix 2 for the ranking methodology and Appendix 3 for the legal and regulatory upgrading actions undertaken by ADB.

43. This is the second nonsovereign loan to the leasing sector in Viet Nam. The ADB Board approved the first nonsovereign loan to Vietcombank, for onlending to its leasing subsidiary, in December 2007.²⁶ At the time, the ADB project team brought to the attention of the Board the interest expressed by Sacombank, another qualifying bank, and its leasing company, to participate in ADB's nonsovereign loan. However, because interest was expressed late, in

²⁵ Under TA 4781, March–October 2007, ADB undertook a series of consultations with the leasing companies and the Government to clarify the use of self help and thereby facilitated the issuance of Circular No. 08/2007/TT-NHNN-BCA-BTP, dated 10 October 2007, *Guidelines on repossession and settlement of leasing assets of leasing company*. This circular clarifies the rights of the leasing companies to the recovery of assets through the use of self help and the timelines and provides clear guidelines on the scope of involvement by Government ministries and people's committees in this area.

²⁶ In December 2007, the Board strongly requested that there be a level playing field between the public and private sector and that the next ADB nonsovereign loan consider a JSB bank and subsidiary leasing company.

October 2007, ADB indicated that the loan to Saccombank would need to be processed further to full due diligence and submitted the loan request for ADB Board approval in 2008.

44. ADB is proposing to provide a senior loan to the Borrower of up to \$25 million. The Borrower will onlend \$5 million to its fully owned subsidiary, SLC, to support the development of lease financing, particularly for equipment lease financing, which is an area of growing demand from Viet Nam's manufacturing SMEs. To facilitate access to finance, it is proposed that the bank and the leasing company relend repayments on term loans and leases as long as the maturity falls within the tenor of the ADB loan.

V. INVESTMENT BENEFITS, IMPACTS, ASSUMPTIONS, AND RISKS

A. Justification

1. Development Outcome

45. ADB's sequential activities in the leasing sector are expected to create a demonstration effect in both the SOCB and the JSB sector regarding the commercial benefits of leasing to SMEs. The loan is a pilot that will facilitate improved access to medium-term leases from SLC to SMEs in Ho Chi Minh City and Hanoi. Co-locating the leasing company in 30 bank branches will (i) create a demonstration effect for the industry on the cost-effective delivery of SME lease financing within the parent branch network; (ii) allow SLC to incubate smaller SMEs that access the formal financial sector through leasing and refer smaller SME customers with a credit history in SLC to the bank, thereby facilitating their formal access to complementary short- and medium-term finance instruments; and (iii) gradually allow SLC to take over the equipment financing activity provided by the parent, which is more costly to SMEs in terms of collateral requirements, and grow the more competitive equipment lease financing provided by the leasing company. The small size of the loan and the small market share of SLC, at only 2% of the leasing industry, will guard against an adverse impact on competition. As a percentage of bank assets, Saccombank holds 6% of the assets of the eight largest banks in Viet Nam. The low impact on competition has been verified in consultations with public and private entities held at SBV. Interest has been expressed by other qualifying SOCB and JSB leasing companies in accessing a subsequent ADB loan in the area of lease financing. The loan will promote the following developments:

- (i) **SME growth and leasing industry strengthening.** Access to finance for SMEs is at present highly constrained, particularly for term loans and in amounts that range between \$125,000 and \$250,000, by banks' high collateral requirements and demands for an established credit history. It is estimated that ADB's loan will fund up to 70 new financial leases to SMEs at terms of 3–5 years, assuming 75% of the loan equivalent is revolved once by the leasing company, and between 80 and 160 new loans to SMEs referred to the bank through the leasing company. Term funding provided by ADB to the parent bank will allow for relending either dong or dollars to the bank and the leasing company as per their requirements. At present, Saccombank provides both dong and dollar loans, and Saccombank leasing company provides financial leases in both dong and dollars at adjustable rates.
- (ii) **Job creation and revenue generation.** Improved access to finance for SMEs, in particular those in labor-intensive manufacturing and to a lesser extent in transportation, will create jobs and generate revenue. Leasing companies

indicate that their present customer base has an employee roster ranging from 50 to 300. The loan will thus directly assist in creating approximately 10,000 additional jobs in Ho Chi Minh City and Hanoi.

- (iii) **Capital markets development.** Leasing companies can help develop capital markets over time. Once they establish an operating history and a portfolio of term leases, they will be able to begin securitizing lease receivables, taking some assets off the balance sheet to achieve a higher leverage and better returns, thus developing an additional tradable instrument on the national capital market.
- (iv) **Strengthening of the banking sector.** The Government has identified the banking sector as a priority for reform. The proposed ADB assistance is in the area of corporate governance and market-based business strategy, policy, and planning and provides a means to strengthen the banking sector at a time of inflationary risk. Co-locating lease finance services in over 30 bank branch networks will (a) facilitate the referral of new SMEs within the bank network; (b) improve the integrated delivery of lease finance and SME finance as a more comprehensive financing tool for SMEs in the present restrictive credit market; (c) allow SMEs to conserve cash and hedge their financing risks across more than one financing instrument; and (d) allow for two-stage due diligence of the customer by SLC and the bank, thus protecting the institutional portfolio from risk.

2. Investment Objectives

46. ADB's objectives for the proposed loan are to (i) create a demonstration effect in the banking industry on the complementary delivery of leasing and credit instruments; (ii) facilitate SMEs' access to the formal financial sector via leasing while preserving their cash by treating the equipment as collateral; and (iii) create efficiency and maximize service delivery on a prudential basis to the expanding SME sector²⁷ through the integrated SME credit reference system from the leasing company to the parent bank.

47. The proposed loan will enable Sacombank to meet its dual objective of (i) extending term leases to SMEs through SLC through its branch networks in Ho Chi Minh City and Hanoi and (ii) facilitating complementary SME credit on a prudent basis. The capacity building²⁸ provided by ADB over March–October 2007 to 10 leasing companies in Viet Nam will help SLC further improve the pricing of its leases as per market risk and the marketing of its financial lease products.

3. Design and Monitoring Framework

48. ADB has prepared a design and monitoring framework and will measure the expected development impact of the loan in accordance with ADB's *Management Development Results Policy*.²⁹

²⁷ Consultations held by ADB with leasing companies and SMEs in Hanoi and Ho Chi Minh City indicate that suppliers on contract with the leasing company comply with technical standards specified by the leasing company and the SME customer base.

²⁸ All training materials developed under TA 4781 will be provided to SBV and the 10 leasing companies to facilitate ongoing in-house training during the implementation of the loan.

²⁹ ADB. 2007. *Management Development Results Policy*. Manila.

4. Fit to Sector and Country Strategy and Program

49. The CSP highlights rapid GDP growth in Viet Nam, averaging 7.5% over the past decade, arising from strong export performance (with exports representing 61% of GDP in 2005), increased employment share in manufacturing and services, and high inward remittances. Accession to WTO in January 2007 will facilitate sustained export growth and ongoing diversification in manufacturing and services, as well as the ongoing development of the private sector. It is estimated the private sector accounted for almost 90% of the 7.5 million jobs created in 2005, of which 64% were generated by SMEs. The CSP highlights the need for “the Government and ADB...to focus on facilitating increased private sector investment and developing market institutions needed to promote competitiveness and create jobs.”³⁰

50. **Business-Led Growth.** Support for business-led growth is a major focus of the CSP. Sector and subsector selection has been prioritized on the basis of the following factors: (i) ADB’s successes and comparative advantages, (ii) the Government’s needs underlined by continued commitment to policy and institutional reforms, (iii) bottlenecks that hamper the creation of an enabling environment for inclusive business-led growth and job creation, and (iv) evidence of a financing gap that cannot be met by private or grant financing.³¹ The complementary lease and SME credit loan fully meets the Government’s objective of improving SME integration in the formal financial sector through lease financing and creates a demonstration effect for the banking industry on complementary product development.

51. ADB supports the development of the financial sector through assistance to banks and nonbank financial institutions such as leasing and insurance companies. ADB’s Medium-Term Strategy II (2006–2008)³² sets as a priority strengthening the financial sector in member countries.

52. The CSP identifies the need for ADB to assist in developing capital markets, particularly the bond market, in Viet Nam. As the primary market for leasing develops—and as leasing companies develop leases with both fixed and flexible rates, thus allowing for standardizing lease documents—there will be an opportunity to refinance the lease portfolio as it gains volume. This will eventually allow the issuance of lease-backed securities.

53. Finally, the CSP envisages a rapid migration of Vietnamese from rural to urban areas in the coming years. This loan will facilitate employment generation by SMEs to absorb this growing labor supply. The project contributes to developing SMEs by extending the term structure of available financial lease products.

54. **ADB’s Support for Leasing.** ADB’s initiative to address the issue of leasing builds on its private sector activities in this area. ADB actively promotes the leasing industry in Asia and has provided technical assistance to support the emergence of this activity, which has proved its effectiveness, particularly in countries where the banking sector was not able to offer loans with adequate tenor to secure the acquisition of capital goods.

³⁰ ADB. 2006. *Viet Nam: Country Strategy and Program 2007–2010*. Manila (para. 14).

³¹ ADB. 2006. *Viet Nam: Country Strategy and Program 2007–2010*. Manila (para. 109).

³² ADB. 2006. *Medium-Term Strategy II 2006–2008*. Manila.

B. Social and Environmental Safeguard Policies

55. The loan has been assigned a category F1 environmental classification as per ADB's *Environment Policy* (2002) and is classified category C with respect to ADB's *Policy on Indigenous Peoples* (1998) and *Involuntary Resettlement Policy* (1995). Sacombank and SLC will be required to maintain an environmental management system following the guidelines agreed with ADB. Sacombank and SLC continue to receive IFC technical assistance on environmental due diligence upgrading, most recently on clean technologies.

C. Anticorruption Policy and Combating Money Laundering and the Financing of Terrorism

56. As an FSPL II policy action, the Government set up and operationalized the Anti-Money Laundering Information Center in SBV to support the Anti-Money Laundering Decree implemented in 2005. The staffing of the center and the implementation of standard operating procedures supported by an information technology system will allow for monitoring commercial bank transactions by end-2008. Viet Nam is now a member of the Asia/Pacific Group on Money Laundering. Vietcombank was advised of ADB's *Anticorruption Policy* (1998, as amended to date) and policy relating to the *Combating of Money Laundering and the Financing of Terrorism* (2003). Consistent with its commitment to good governance, accountability, and transparency, ADB will require in the reimbursement and indemnity agreements that Sacombank institute, maintain, and comply with internal procedures and controls following international best practice standards for the purpose of preventing corruption or money laundering activities or the financing of terrorism. Further, Sacombank will undertake to refrain from engaging in such activities. The documentation between ADB and Sacombank will further allow ADB to investigate any violation or potential violation of these undertakings. The loan covenants will extend to SLC.

57. The CSP highlights the Government's commitment to combating corruption through its decision to join the United Nations Convention Against Corruption in 2003 and the ADB-OECD Anticorruption Initiative for Asia and the Pacific in 2004, and by laws implemented in 2006 to address corruption and improve transparency, particularly in the areas of public procurement, construction, state audit, civil service, and land administration.³³

VI. ASSURANCES

58. **No Objection Letter.** Consistent with the Agreement Establishing the Asian Development Bank, the Government of Viet Nam will be requested to confirm that it has no objection to the proposed loan to Sacombank. The loan will not be disbursed until ADB receives such confirmation.

59. **Documentation.** ADB will enter into suitable documentation, in form and substance satisfactory to ADB, following approval of the proposed financing by the Board of Directors.

VII. RECOMMENDATION

60. I am satisfied that the proposed loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the loan of up to \$25,000,000 to the Saigon Thuong Tin Bank (Sacombank) from ADB's ordinary capital

³³ ADB. 2006. *Viet Nam: Country Strategy and Program 2007–2010*. Manila (page 9).

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resources, on terms and conditions as are substantially in accordance with those set forth in this report and as may be reported to the Board.

Haruhiko Kuroda
President

18 November 2008

STATE BANK OF VIETNAM PROVISION GUIDELINES

The State Bank of Vietnam approved with Decision 493/2005/QD-NHNN two methods for commercial banks to calculate provisioning for nonperforming loans (NPLs). Loan classifications and provision for losses are made in accordance with SBV's Decision No. 493/2005/QD-NHNN, dated 22 April 2005, and Decision No. 18/2007/QD-NHNN, dated 25 April 2007. Commercial banks using Vietnamese accounting standards determine provisioning for NPLs on the basis of "passage of time," as indicated in Article 6 of the decision. Commercial banks that have made the transition to international financial reporting standards rely on provisioning based on a "discounted cash flow" valuation of NPLs, as indicated in Article 7 of the decision. SBV has set the haircuts to be taken on different types of collateral before calculating provision.

Table A1. Classification Definitions as per Decision 493/2005/QD-NHNN

Classification Article 6 (Passage of Time)	Specific Provision (%)	Classification Article 7 (Risk Rating System)	Specific Provision (%)
Group 1: Standard debts • Undue debts for which principal and interest are assessed by credit institutions to be fully recoverable when due	0	Group 1: Standard debts • Debts for which principal and interest are assessed by credit institutions to be fully recoverable when they become due	0
Group 2: (Debts with attention being paid to/Special mention) • Debts overdue by less than 90 days • Rescheduled debt overdue	5.0	Group 2: (Debts with attention being paid to/Special mention) • Debts assessed to be fully recoverable (interest + principal) but with signs that borrowers' repayment capacity has declined	5.0
Group 3: (Substandard debts) • Debts overdue by between 90 and 180 days • Rescheduled debts overdue by less than 90 days	20.0	Group 3: (Substandard debts) • Debts (principal + interest) assessed as not fully recoverable with possibility of partial loss	20.0
Group 4: (Doubtful debts) • Debts overdue by between 181 and 360 days • Rescheduled debts between 90 and 180 days overdue	50.0	Group 4: (Doubtful debts) • Debts assessed highly possible of being lost	50.0
Group 5: (Loss) • Debts overdue more than 360 days • Rescheduled debts more than 180 days overdue	100.0	Group 5: (Loss) • Debts assessed as irrecoverable with loss of principal	100.0

Note: The value of the security adjusted debt as per Article 8 of Decision 493 may be deducted from the debt before calculating provision.

Source: Official Gazette No 22 (30-4-2005).

RANKING OF LEASING COMPANIES

To assist in short-listing the leasing companies, the project developed the following ranking system.

Table A2: Ranking Methodology

Total Weighting		100%								
Financial Performance	40%	Corporate Governance	25%	Risk Management	25%	Internal Audit	5%	Business Strategy	5%	
Capital Adequacy	5%	Non Exec Vs Exec	7%	Credit Policies/Procedures	9%	Reports to board of directors/supervisors	1%	Target industries identified	1%	
Equity to Assets	3%	Board of Directors	5%	Documented Policy	1%					
Equity to Recs	1%	Board of Supervisors	2%	Policy widely available	1%	% of leases reviewed pa	1%	Target customers identified	1%	
Total Equity	1%	Meetings p.a	2%	Written approvals	1%					
Profitability	12%	Board of Directors	1%	Approval disbursement	1%	Audit plan in place	1%	SME portfolio	2%	
ROA	3%	Board Duties	7%	Current Fin Inf held	1%					
Actual ROE	3%	Separation of duties	5%	# times pa asset checked	1%	Audit manual in place	1%	# of partnerships with suppliers	1%	
Regulatory ROE	3%	Board responsibility for financial integrity	2%	Ins in place	1%					
NIM	1%	Committees	3%	Gtee taken	1%	NPL reviewed	1%	NPL Reviewed	1%	
Int Inc/Rec	1%	Credit	1%	Board app large trans	1%					
Asset Quality	18%	ALCO	1%	Credit Recovery	4%					
NPL/Gross Recs	5%	Others	1%	Full review of PD	1%					
Sp Men/Gross Recs	5%	Provision	4%	Guidelines in place	1%					
Unprovide NPLs/Equity	4%	Exceeds SBV req	1%	Separate unit	1%					
Prov to NPLs	4%	Gen prov made	1%	Board Monitor	1%					
Productivity	5%	Ind auditors confirm	2%	Oper/Market Risk	3%					
Non Int Exp/Inc	2%	Transparency	2%	Operation Manual	1%					
Assets/FTE	1%									
Profit/FTE	1%									

ALCO = asset liability committee, FTE = full-time equivalent (resources), NIM = net interest margin, NPL = nonperforming loan, p.a. = per annum, PD = portfolio development, ROA = return on asset, ROE = return on equity, SBV = State Bank of Viet Nam, SMEs = small and medium-sized enterprises.
Source: Leasing companies' financial statements.

THE LEGAL ENVIRONMENT GUIDING THE LEASING SECTOR IN VIET NAM

A. Policy Reforms in the Leasing Sector

1. The Government of Viet Nam (the Government) implemented a series of policy and legal reforms under the Financial Sector Program Loan (FSPL) II and the Sector Development Program Loan to assist the development of the leasing sector. Leasing companies are licensed and regulated by the State Bank of Vietnam (SBV) and regarded as nonbank credit institutions under the Law on Credit Institutions. SBV's Decree 16/2001 ND/-CP, issued on 2 May 2001, provided the broad legal framework for leasing operations. The decree authorizes only those financial leasing companies licensed by SBV to undertake finance leasing transactions. The activities of leasing companies were initially restricted to financial leasing for machinery, equipment, vehicles, other moveable assets, and other services related to financial leasing operations.

2. The Government issued Decree 65/2005/ND-CP on 19 May 2005 to amend Decree 16, allowing for operating leasing, the sale of finance lease receivables and lease back, and syndicated lease transactions. Decree 65 provides for a limit of exposure to a single client equal to 30% of all capital of a finance leasing company and outlines the broad procedures for enforcing leasing contracts. However, inconsistencies remain in the implementing guidelines on enforcement as reviewed with the Government and leasing companies in interministerial consultations held at SBV in the second and third quarter of 2007. FSPL III, approved in 2007, will maintain a policy dialogue with the Government on continuing measures to improve enforcement procedures as reviewed in interministerial consultations.

3. On 25 August 2008, the Government issued Decree 95/2008/ND-CP, amending some of the articles of Decree 16/2001/ND/CP of 2 May 2001, on the organization and operation of financial leasing companies. The new decree clarifies that a financial leasing company is a nonbank credit institution, a Vietnamese entity that is established and operates in Viet Nam as either of the following (refer also to para. 38 of the main text of the report and recommendation of the President): (i) a shareholding company, (ii) a limited company of at least two members, and (iii) a limited company of one member. Joint venture financial leasing companies (none at present) and 100% foreign-invested financial leasing companies (two), are respectively in the last two categories. These entities are eligible to obtain an operating license if their total corporate assets are over \$10 billion at the end of the preceding year.

B. Legal and Regulatory Environment for the Financial Leasing Industry

4. The financial leasing industry is regulated by a complex matrix of appropriate laws³⁴ Regulation by SBV is through the issue of circulars and decisions and through inspection, both onsite and off. Offsite inspection is on a continuous reporting basis, while onsite inspection is every 3 years, unless circumstances require more frequent inspections. Inspection is undertaken from Hanoi. In the past 12 months, warnings have been given in respect of asset concentration and client concentration. Inspection is traditional and not risk based.

5. Financial leasing companies are required to provide the inspector with their procedures for rescheduling the period of lease payments.³⁵ Leasing companies do not currently have

³⁴ See the Decree on the Organisation and Operation of Finance Leasing Companies, the Credit Institutions Law 02-1997-QH10, the Financial Leasing companies, being defined as credit institutions, the Law on the State Bank of Viet Nam 06-1997-QHX and the Decree on Security Transactions 163/2006/ND-CP 29. 12. 2006, the Civil Code and the Commercial Law. Decision 1675/2004/QD-NHNN dated 23 December 2004 of the State Bank of Viet Nam promulgating regulations on organization and operation of banking inspector.

³⁵ See Circular 05/2006/TT-NHNN 25 July 2006, article 11.2.b.

rescheduling policies and rely upon the policies of their parent banks. Apart from this issue, the legal regulatory regime is detailed, prescriptive, and in line with appropriate practice. There are issues in respect of the implementation of some of the decrees.

6. SBV Decision 03/2007/QD-NHNN, issued in January 2007, places a cap equivalent to 10% of parent bank equity on parent bank funding to subsidiary leasing companies and requires onlending to be extended at commercial interbank rates. There have been no further changes or revisions to Decision 3 to date in 2008.

7. Value-added tax is applied on the purchase of assets for lease but not on the lease transactions. The input credit is passed to the lessee, and there is no double taxation upon the sale of a leased asset to a lessee.³⁶ Satisfactory provision of depreciation is found in the Decision on the Regime on Management, Use, and Calculation of Fixed Assets.³⁷

C. The Private Legal Regime

8. Additional specifications in the financial leasing agreement are required to adequately minimize of risk for the financial leasing company and to assist it in recovering its leased asset in the event of default. It is unclear from the civil code whether the power of attorney can be used in repossession. This will be clarified under further due diligence.

D. Repossession and Bankruptcy

9. Repossession is reported by the financial leasing companies as being difficult. To address this, Decree No 65 was passed in May 2005. It provides for self help in the recovery of the leased assets without the intervention of the courts. The implementation of the decree has been difficult, with public officials not applying or enforcing it. This matter needs to be addressed under FSPL III.

10. Bankruptcy Law No: 21/2004/QH11 is modern and effectively drawn. The court rules in respect of bankruptcy proceedings have been drawn and are operational.³⁸

11. The practical implementation of the Bankruptcy Law is a problem. It is a complex and specialized area of the law requiring additional training for the judiciary, the legal profession, accountants, officers of financial leasing companies, and others involved in the financial system. As an important part of the armory for recovering debts due to financial leasing companies, attention to this matter is required, and it is being addressed under FSPL III.

E. Action Taken by Leasing Companies over 2007–2008

12. Technical assistance (TA) 4781 undertook a series of consultations with leasing companies to upgrade lease agreements and thus reduce the risks and costs of repossession. Four pro forma lease agreements were developed under the technical assistance for Small and Medium-Sized Enterprise Development Program–Subprogram II³⁹ adapted to individuals, private companies, and public companies, as well as for airplanes. In 2008, leasing companies have begun to implement

³⁶ Refer to the Law on Value Added Tax as amended to 17 June 2003 2000 Circular 120/2003/TT-BTC, Circular No 24-2002-TT-BTC, 20.3.2002.

³⁷ No. 206-2003-QD-BTC.

³⁸ Available: <http://www.asianlii.org/vn/other/benchbk/244-en.html>.

³⁹ ADB. 2006. *Technical Assistance to the Socialist Republic of Viet Nam for Small and Medium-Sized Enterprise Development Program–Subprogram II*. Manila (TA 4781-VIE, for \$600,000, approved on 20 April).

the following measures to strengthen their growth: (i) upgraded lease agreements to ensure both lessor and lessee are equally aware of obligations under the contract and knowledgeable about the use of self help as well as recourse to power of attorney, (ii) improved integration and association with suppliers to assist the valuation of the item to be repossessed and its resale, (iii) restricted financing of one-off assets used by a very limited number of companies, (iv) specialization of leasing officers in specific industries and equipment, and more recently (v) improved coordination between the parent bank and the leasing subsidiary to ensure the consistent marketing of lease finance products. Other measures being introduced include improved marketing campaigns and organization of workflow, specifically the separation of active from nonperforming accounts into specialized units, as well as improved performance measures.