Viet Nam: Financial Sector Assessment, Strategy, and Road Map

This sector assessment, strategy, and road map highlights the Government of Viet Nam’s plans and strategies for addressing priority needs for the financial sector and identifies possible preliminary areas of international assistance. It assesses key sector development needs by analyzing strengths, constraints and weaknesses, various risks, potential threats, as well as opportunities. This knowledge product serves as a basis for further dialogue on how the Asian Development Bank and the government can work together to tackle the challenges of managing financial sector development in Viet Nam in the coming years.

About the Asian Development Bank

ADB's vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries reduce poverty and improve the quality of life of their people. Despite the region’s many successes, it remains home to approximately two-thirds of the world’s poor: 1.6 billion people who live on less than $2 a day, with 733 million struggling on less than $1.25 a day. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

Based in Manila, ADB is owned by 67 members, including 48 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance.
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Currency Equivalents
(as of 1 April 2014)

Currency Unit  =  dong (D)
D1.00          =  $0.000047
$1.00          =  D21,080.00
Acknowledgments

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### Abbreviations

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<tr>
<th>Abbreviation</th>
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<tr>
<td>ADB</td>
<td>Asian Development Bank</td>
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<td>ASEAN</td>
<td>Association of Southeast Asian Nations</td>
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<td>ASR</td>
<td>assessment, strategy, and road map</td>
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<tr>
<td>BIDV</td>
<td>Bank for Investment and Development of Vietnam</td>
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<td>CAPE</td>
<td>country assistance program evaluation</td>
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<td>CCF</td>
<td>Central People’s Credit Fund</td>
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<td>CCP</td>
<td>central clearing counterparty</td>
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<td>CPS</td>
<td>country partnership strategy</td>
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<td>EEA</td>
<td>emerging East Asia</td>
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<td>EMCC</td>
<td>Economic Management Competitive Credit</td>
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<td>FSAP</td>
<td>Financial Sector Assessment Program</td>
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<td>FSPL</td>
<td>financial sector program loan</td>
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<td>GDP</td>
<td>gross domestic product</td>
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<td>GIZ</td>
<td>Deutsche Gesellschaft für Internationale Zusammenarbeit GmBH</td>
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<tr>
<td>HNX</td>
<td>Hanoi Stock Exchange</td>
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<td>HOSE</td>
<td>Ho Chi Minh City Stock Exchange</td>
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<td>IAS</td>
<td>International Accounting Standards</td>
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<td>IAIS</td>
<td>International Association of Insurance Supervisors</td>
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<td>IFC</td>
<td>International Finance Corporation</td>
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<td>IFRS</td>
<td>International Financial Reporting Standards</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<td>ISA</td>
<td>Insurance Supervisory Agency</td>
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<td>IT</td>
<td>information technology</td>
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<td>JICA</td>
<td>Japan International Cooperation Agency</td>
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<td>JSCB</td>
<td>joint stock commercial bank</td>
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<td>MFI</td>
<td>microfinance institution</td>
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<td>MFSD</td>
<td>Monetary and Financial Stability Department</td>
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<td>MOF</td>
<td>Ministry of Finance</td>
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<td>NPL</td>
<td>nonperforming loan</td>
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<td>PCR</td>
<td>program completion report</td>
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<td>PCF</td>
<td>People’s Credit Fund</td>
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<td>PFM</td>
<td>public financial management</td>
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<td>SBV</td>
<td>State Bank of Vietnam</td>
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<td>SECO</td>
<td>Swiss State Secretariat for Economic Affairs</td>
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<td>SEDP</td>
<td>Socio-Economic Development Plan</td>
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<td>SERD</td>
<td>Southeast Asia Department</td>
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<td>SMEs</td>
<td>small and medium-sized enterprises</td>
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<td>SRO</td>
<td>self-regulatory organization</td>
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<td>SSC</td>
<td>State Securities Commission</td>
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<td>SOCB</td>
<td>state-owned commercial bank</td>
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<tr>
<td>Acronym</td>
<td>Full Form</td>
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<td>SOE</td>
<td>state-owned enterprise</td>
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<td>TA</td>
<td>technical assistance</td>
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<td>TSA</td>
<td>Treasury Single Account</td>
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<td>VAS</td>
<td>Vietnamese Accounting Standards</td>
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<td>VAMC</td>
<td>Vietnam Asset Management Company</td>
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<td>VBMA</td>
<td>Vietnam Bond Market Association</td>
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<td>VBSP</td>
<td>Vietnam Bank for Social Policies</td>
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<td>VRM</td>
<td>Viet Nam Resident Mission</td>
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<tr>
<td>VSD</td>
<td>Vietnam Securities Depository</td>
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<td>VSS</td>
<td>Vietnam Social Security System</td>
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1. The Southeast Asia Department of the Asian Development Bank (ADB) is systematically updating its sector assessment, strategy, and road maps (ASRs) to better harmonize project planning and programming with developing member countries and development partners. The previous financial sector ASR was linked to ADB’s country partnership strategy (CPS) for Viet Nam, 2012–2015. This updated ASR documents ADB’s current assessment of Viet Nam’s financial sector and outlines strategic investment and reform priorities of the government and ADB.

2. The ASR highlights sector performance, development constraints, government plans and strategies, past ADB operations and experience, other development partner support, and the strategy for future ADB support. It is based on the specific needs of Viet Nam, and drawn from a review of available studies, other documents, and websites, as well as regular policy dialogue with officials of the Government of Viet Nam, development partners, and other stakeholders. Given a lack of comprehensive in-depth reporting on Viet Nam’s financial subsectors, an absence of current statistics in some areas, and a rapidly progressing reform agenda, this assessment is based on the best information available at the time of writing.

3. This ASR will help provide sector background information for future program, investment, and technical assistance (TA) operations. The ASR also forms a basis for further dialogue between the government and ADB in financial sector programming and coordination with development partners. The sector road map and results framework appears in Appendix 1. The problem tree is in Appendix 2.

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A. Overall Sector Context

4. Viet Nam has made significant progress in transitioning from a centrally planned economy to a market-oriented system. Political and economic reforms (*doi moi*) initiated in 1986 when Viet Nam’s per capita income was only $437, helped the country achieve a lower middle-income status and reach a per capita income of $1,755 in 2013. As a result, the population living in absolute poverty—defined as less than $1.25 a day—has fallen sharply to 16.9% in 2008 from 63.7% in 1993. Good progress has also been made toward achieving the Millennium Development Goals.

5. The government aspires to reach higher middle-income country status, with a per capita income of at least $3,000 and significant improvements in human development and poverty reduction by 2020. Specifically, the government aims at an average annual reduction in the number of poor households by 2%–3%. To meet these objectives, the Socio-Economic Development Plan (SEDP) 2011–2020 provides a road map to transform the country into a modern, productive, and equitable market economy.

6. Viet Nam will need to fundamentally reshape its financial sector to support these long-term socioeconomic goals by more efficiently and effectively directing its high national savings—30.7% of gross domestic product (GDP) in 2012—toward productive investment. This is particularly important as it has become increasingly hard to sustain high economic growth rates. Average GDP growth per year exceeded 7% during 2004–2007, but fell below 6% during 2008–2013 in the wake of the global financial crisis.

7. First and foremost, there is a need to recapitalize and further reform the banking sector. Specifically, the banking sector suffers from high levels of nonperforming loans (NPLs), undercapitalization, and a suboptimal allocation of resources. Its intermediation may be too limited, inefficient, and distorted to support a return to high growth rates. These problems are compounded by the banking sector’s central role in the economy.

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2 Empirical studies demonstrate a close relationship between financial sector development and poverty alleviation. See for instance: G. Jeanneney, S. Kpodar, and K. Kpodar. 2008. Financial Development and Poverty Reduction: Can There Be a Benefit Without a Cost? *International Monetary Fund Working Paper*. No. 62. Washington, DC. In this study, a 10% increase in the broad money to GDP ratio was estimated to raise incomes of the poorest 20% of households by 3%–5%. The relationship between financial sector development and poverty alleviation operates through various channels. For example, higher economic growth can lead to more employment, wage increases, and so on. Improved access to financial services in the form of savings products (e.g., bank accounts and pensions) or credit for entrepreneurs can increase lifetime income of the poor as well. Increased financial sector stability also benefits the poor, who tend to have fewer and less diversified assets and are more exposed to the negative macroeconomic impact that normally accompanies a financial crisis.
8. While bank-specific weaknesses need to be addressed, it is equally important to develop a healthy nonbank financial sector. The stock and corporate bond markets could help provide a more reliable supply of long-term funding to the private sector, but remain underutilized (Figure 1). Reforms in these markets could strengthen the economy's resilience to shocks, mitigate risks posed by an overreliance on the bank-dominated financial sector, and improve the allocation of resources.

![Figure 1: Financial Sector Composition (% of GDP)](chart.png)

**GDP = gross domestic product.**
**Sources:** World Bank. 2014; AsianBondsOnline. http://asianbondsonline.adb.org/

9. The size of the local currency bond market was, with 16.9% of GDP in the fourth quarter of 2013, far below the average of 56.5% in emerging East Asia (EEA). Although recent growth and progress is noted, such markets remain underdeveloped and suffer from low liquidity and very short maturities. On the short end of the debt market, well-functioning money markets are essential to support effective monetary policy and to provide the short-term reference rates used for pricing financial instruments. However, lending volumes have declined considerably in recent years, with tenors shortening to less than 3 months due to excess liquidity, restrictive regulations, a lack of confidence, and heightened credit risk concerns.

10. More could also be done to stimulate contractual savings, such as insurance and pensions, as a source of demand for government and corporate bonds, infrastructure finance, and other long-term financial instruments. While insurance penetration rates of around 1.4% are comparable to that of Indonesia and the Philippines, they remain far below that of Thailand and Malaysia and the global average of 6.6%. Moreover, the Vietnam Social Security System (VSS) has the potential to become an important and professional institutional investor with improved fund management and more investment flexibility.

11. The reform agenda should also support the transition to a more modern central bank. In the long run, there is a need to increase its fiscal and operational autonomy, as well as its technical

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3 Emerging East Asia includes the People’s Republic of China; Hong Kong, China; Indonesia; the Republic of Korea; Malaysia; the Philippines; Singapore; Thailand; and Viet Nam.
capacity. At the same time, the government may need to gradually relax various state-sponsored mechanisms that provide directed credit at predetermined rates such that capital can flow to more efficient uses. Broader capacity development will be required to further boost the effectiveness of supervision and to strengthen the formal investor and consumer protection mechanisms necessary for financial market confidence. Last but not least, given the increasing interconnectedness within the financial system and between banks and the real economy, it is essential to strengthen systemic risk monitoring and macroprudential policy, and further restructure state-owned enterprises (SOEs) to reduce the related drain on available capital resources.

12. To effectively tackle these issues, the government and development partners must overcome a number of obstacles. The complexity and interrelatedness of needed reforms require proper sequencing, long-term government commitment, close consultation with stakeholders, and targeted support from development partners. As a start, interagency and intra-agency coordination must be further improved to avoid implementation delays due to convoluted approval mechanisms. Similarly, donors need to improve their coordination and to progressively emphasize achieving tangible results.

13. Recognizing the need for reforms, Viet Nam has provided commitments under various proposed regional trade agreements, such as the Association of Southeast Asian Nations (ASEAN) Economic Community 2015 and the Trans-Pacific Partnership. These commitments include further liberalization of the financial sector. Given their highly ambitious nature, maintaining momentum for reforms over the medium term will be essential to meet all ASEAN Economic Community targets by 2015.

14. This ASR will examine these and other issues in more detail and show that necessary reforms cover a broad range of areas. The following section provides an overview of seven subsectors: (i) banking, (ii) the money market, (iii) bond markets, (iv) the stock market, (v) insurance, (vi) social security, and (vii) microfinance. The section is followed by an analysis of crosscutting issues that need to be reinforced, namely coordination and planning, market principles, central bank independence, the investor base, investor and consumer protection, supervision, accounting standards, and clearing and settlement.

B. Subsector Context

15. Banking sector. The banking sector’s intermediation is inefficient, and constrained by its weak balance sheet and undercapitalization. Joint stock commercial banks (JSCBs) have grown in importance, but have been unable to break the dominance of the state-owned commercial banks (SOCBs). Since 2007, the market share of SOCBs has hovered slightly above 50% as these entities continue to provide directed and often subsidized credit to select industries (Figure 2). These loans often support the immediate cash needs of less productive enterprises while crowding out the legitimate credit needs of the private sector. For example, preferential loans to SOEs accounted for over three-quarters of the assets of the Vietnam Development Bank in 2009. Easy terms, limited disclosure requirements, and weak supervision seem to have made financing through the State Capital Investment Corporation, 4 Vietnam Development Bank, and other commercial banks more attractive to SOEs than other channels. 5

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4 The State Capital Investment Corporation is a sovereign wealth fund with 407 companies in its investment portfolio at the end of 2012. The portfolio’s book value was $710 million.

16. Compounding this problem, NPLs proliferated due to rapid lending growth through the 2008 global financial crisis, followed by a credit squeeze in 2011, a decline in real estate prices by roughly 60% from their 2009–2010 peak levels, a stagnating economy, and poor performance by some highly leveraged SOEs. Governance weaknesses of JSCBs have reportedly contributed to this problem as they were required by some of their major stockholders to lend to high-risk projects in which their controlling shareholders had commercial interests. In turn, NPLs have had a negative impact on the amount of bank credit provided in recent years. Credit growth was 8.9% in 2012, the lowest in many years and short of the central bank's 14%–16% target. Despite a recovery to 12.5% in 2013, credit growth remains constrained by uncertainties over NPLs, the gradual pace of banking reform, and slack demand. While most experts believe that NPLs in the banking system are still high, there is a great deal of uncertainty regarding the actual level (Box 1). Given the pivotal role of the banking sector in Viet Nam's economy, it is important to increase the transparency of NPLs and bolster efforts to bring them down to more sustainable levels.

17. Foreign investment could play a critical role in satisfying recapitalization needs of the banking sector. Such capital injections are likely to come with improved corporate governance, and transfers of skills and technology. Although investment in the domestic banking system by foreign investors has increased and restrictions have been loosened, interest from strategic investors remains constrained by limits on foreign ownership and other measures.

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6 About 53% of NPLs are from state-owned enterprises.
7 Footnote 5.
8 There are additional challenges. Liquidity risk is elevated as virtually all of the commercial sector’s long-term credit needs are funded through short-term bank deposits. This practice has produced a large structural maturity mismatch. In addition, commercial banks in Viet Nam are quite small, with total assets of the 10 largest banks averaging only D285 trillion ($13.7 billion) in July 2012. The total assets of leading banks are estimated at $60 billion in Indonesia and $66 billion in Thailand. The limited pace of growth and consolidation has perpetuated a system with limited operational efficiency. There are also concerns about the valuation and liquidity of collateral after sharp declines in real estate prices. Banking sector risks are compounded by a weak regulatory and supervisory framework and deficient financial infrastructure.
Box 1: Nonperforming Loans

Fitch Ratings has estimated system-wide nonperforming loans (NPLs) to be 3–4 times higher than the 4.9% reported by banks in September 2012. Similarly, Moody’s Investor Service reported in February 2014 that the share of problem assets in the banking system was at least 15%. These numbers exceed the formal State Bank of Vietnam (SBV) estimates of 3.9% or D122 trillion ($5.7 billion) by February 2014 (9.7% or D308 trillion when including restructured loans). Differences between official and bank-reported figures for NPLs were said to reflect:

(i) Decision 780 issued in April 2012 allowing commercial banks to continue classifying rescheduled loans as performing loans based on subjective assessment of the soundness of a creditor’s business operation,

(ii) nonadoption of fair value in Vietnamese Accounting Standards (VAS),

(iii) nonsystematic reporting to the credit information center,

(iv) noncompliance with reporting rules promulgated by the supervisory agencies,

(v) a reliance on quantitative methods without considering qualitative factors such as business results of enterprises, and

(vi) a different treatment of loan classification in VAS and International Accounting Standards (IAS).

However, notable progress is being made in making NPLs more transparent. In January 2013, the SBV issued Circular 02 to improve loan classification and provisioning to come into effect from June 2013. It required banks to adopt policies closer to international good practice in calculating NPLs, but its implementation was delayed by a year in light of a lack of readiness of commercial banks to adopt the enhanced regulation. The application deadline for important requirements was further extended to 2015 by Circular 09, which became effective on 20 March 2014. On the positive side, Circular 09 will require banks to manage their debts more stringently than Circular 02, particularly with regard to corporate bonds and periodic collateral assessments to ensure that values are in line with market values when determining provisions.


18. Confronted with rising banking sector risks, the State Bank of Vietnam (SBV) requested the International Monetary Fund (IMF) and the World Bank to conduct a Financial Sector Assessment Program (FSAP) to give recommendations on financial sector restructuring. The FSAP report diagnosed and recommended solutions for a number of weaknesses in the financial sector. When discussing the 2013 Article IV Consultation with Viet Nam, Executive Directors “encouraged following the steps recommended by the FSAP [to return the banking system to health]. In particular, measures should be put in place to recapitalize banks, strengthen banking supervision and regulation, and implement the workout scheme for NPLs. Strengthening credit risk analysis and governance by promoting greater transparency should continue to be a top priority.”

19. Money market. The money market in Viet Nam remains underdeveloped and is segmented. Its underlying constraints need to be addressed, as a deep and well-functioning money market would enable (i) financial institutions to match short-term assets and liabilities, (ii) security dealers

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9 As of end of April 2014, the authorities have yet to disclose the FSAP report or its main findings.

10 The 2013 Article IV Consultation with Viet Nam concluded by the IMF confirmed that “part of the banking system is undercapitalized and under-provisioned and has low profitability. Furthermore, there is cross-ownership among banks and between banks and enterprises, which merits the authorities’ attention and efforts to resolve and prevent the contagion risk. Data limitations and challenges in the regulatory and supervisory framework hampers [sic] an understanding of the true state of the financial system.”
to finance their inventories and to make two-way markets, (iii) corporations to smooth out working capital needs, (iv) the central bank to conduct more effective monetary policy, and (v) the market to price financial instruments based on short-term benchmark rates.

20. Interbank lending volumes have declined considerably since the end of 2011, and tenors have shortened to less than 3 months (Figure 3). The number of active players in the interbank market also declined between 2011 and 2013, with banks tending to trade within the same tier group.\(^\text{11}\) This contraction and ensuing segmentation is due to excess liquidity as commercial banks turned more cautious about the health of other banks. Larger SOCBs tend to hold excess liquidity but are faced with very limited investment opportunities as a substantial part of interbank transactions traditionally takes place on an unsecured basis.\(^\text{12}\)

21. Despite high liquidity, the money market remains volatile and unstable, as evidenced by quotations in the interbank market. Most banks quote a one-way price or wide bid–offer spreads. Declining activity seems to have been exacerbated by regulations and a lack of confidence in policy setting. For instance, in 2012, the SBV introduced risk provisioning requirements on interbank lending to prevent weaker banks from using the money market to finance credit market activities, required standardized agreements when none were available, and prohibited lending to banks with past due interbank loans although such information was not publicly disclosed—policies that had to be relaxed several months later.\(^\text{13}\) While agreeing, in principle, with the need for intervention, market participants suggested that the interbank market would function more efficiently and develop further

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\(^{11}\) A July 2013 money market survey shows that half of interbank trading by joint venture and fully foreign-owned commercial banks was with each other.

\(^{12}\) In a March 2009 money market survey, 81% of respondents indicated that 100% of their money market lending was on an unsecured basis. The 2013 July money market survey concluded that while the repo-agreement market is growing, it remains small relative to the cash market and is limited to transactions between the SBV and commercial banks. Bank borrowing from the SBV has increased exponentially since 2008.

\(^{13}\) Circular 21, which had become effective in September 2012, aimed at addressing a number of risky lending and liquidity positioning practices in the interbank market by, for instance, requiring legal master agreements, appropriate credit limits, and risk provisioning, and by only allowing banks to borrow interbank when they did not have any interbank loans overdue more than 10 days. Money market activity picked up slightly after January 2013, when Addendum 01 relaxed or clarified a number of regulatory restrictions introduced by Circular 21.
if these weak banks were left to fail and stronger banks were allowed to operate under a more flexible regulatory framework.

22. Several barriers may need to be lifted before the money market can fully perform its key functions. For example, doubts about the creditworthiness of counterparties are exacerbated by an inability to obtain reliable qualitative credit assessments. Moreover, there is a lack of standardized agreements, such as for repurchase agreements, and risk provisioning requirements for interbank lending exceeding 3 months provide a disincentive by reducing profit margins on such transactions. There also is a dearth of sufficiently detailed statistics, and it is difficult to use the Vietnam Interbank Offered Rate as a reference rate since it does not fully reflect market conditions.\textsuperscript{14} Quotations provided by domestic banks are not regulated, while many foreign banks stopped contributing after the London interbank offered rate scandal broke in the international market. Until recently, the money market was also constrained because settlement netting of Treasury bills had not been formally recognized.

23. Bond markets. The bond market is showing some encouraging signs. Total local currency bonds outstanding grew by 15.6% year-on-year to D605 trillion (\$28.7 billion) as of the end of December 2013, marking the first time that the amount has topped the D600 trillion mark. In fact, Viet Nam was the most rapidly growing local currency bond market in EEA in the fourth quarter of 2013 on a quarterly basis, due exclusively to government issuance.

24. Nevertheless, Viet Nam remains one of the smallest debt markets in the region. The total local currency bond market amounted to 16.9% of GDP in the fourth quarter of 2013, well below the overall EEA average of 56.5% (Figure 4).\textsuperscript{15} The primary government bond market is regarded by stakeholders as rudimentary and cumbersome. Until recently, issuance adhered to an inflexible reading of government decrees without regard to a wider capital market development agenda.\textsuperscript{16} Issue sizes have also been small, which created problems for investors, depositories, regulators, and exchanges (Box 2).

25. Moreover, public financial management (PFM) needs further strengthening. A broad assessment of country PFM systems shows that existing legislation and guidelines provide a comprehensive legal platform. However, there remain weaknesses at various points in the PFM cycle, particularly budget coverage, internal controls (especially at the subnational level), and legislative oversight of PFM. The government has implemented neither a Treasury Single Account (TSA) nor liquidity forecasting, which has led to inefficiencies in the management of cash balances and higher-than-necessary borrowing costs.\textsuperscript{17}

\textsuperscript{14}In the July 2013 money market survey, merely 1% of responses considered the Vietnam Interbank Offered Rate a reliable benchmark without need for improvements. Suggested remedies included (i) basing it on real traded transactions and quotes (46%), (ii) stricter control and code of conduct (32%), and (iii) including more contributors to the panel (21%).

\textsuperscript{15}This can be disaggregated into 16.5% of GDP for government bonds and 0.4% of GDP for corporate bonds, which compares to EEA averages of 34.8% and 21.7%, respectively. Government-guaranteed bonds issued by the Viet Nam Development Bank, Vietnam Bank for Social Policies (VBSP), and other state-owned enterprises accounted for approximately 33% of bonds outstanding in December 2013, compared to 55% for central government bonds and 3% for municipal bonds.

\textsuperscript{16}Treasury bills with durations under 1 year are auctioned through the SBV. The SBV also issues its own bills via an auction process as part of its open market operations to periodically sterilize excess liquidity. Bonds with durations of more than 1 year are distributed by the State Treasury, and are auctioned through the Hanoi Stock Exchange (HNX) or sold via an underwriting channel.

\textsuperscript{17}Government cash held at different levels and branches of the SBV and state-owned commercial banks (SOCBs) is not centrally consolidated on a daily basis. This prevents the State Treasury from having complete information on all government cash flows and balances, and leaves substantial idle cash holdings at about 700 Treasury offices, which earn below market interest rates. The lack of information on these cash holdings has led to additional borrowing to cover perceived cash shortages, which in turn raises public debt servicing costs.
Further, a rigid mechanism to manage basic dong-denominated interest rates seems to have driven primary issuance to the area of the yield curve where the government might have success rather than focusing on a longer-term projection of the government’s financing needs or a view of the optimum composition of the government’s financing profile. As a result of these limitations, the government debt maturity profile has become highly skewed to the short term, which prevents a long-term yield curve from emerging and represents an elevated...
refinancing risk given the region’s increasing exposure to capital flight (Figure 5). For instance, by December 2013, 68% of the government’s outstanding local currency debt was due within 1–3 years.

27. Secondary market trading is subdued, with only 40% of listed bond codes being traded in 2010. Despite some tightening of bid–ask spreads in 2013, Viet Nam continues to exhibit the widest bid–ask spreads in EEA along with low transaction sizes and counts (Table 1). This reflects a liquidity premium. Bond transactions have been executed through an equity styled trading platform, which relies on brokers acting as put through agents for the transaction input. This oligarchic environment for debt trading, built around securities companies who appear to add little directly to bond or money market development, serves as a barrier to entry. Government bond ownership is also concentrated, with the four largest SOCBs holding around 65% of total outstanding bonds, usually until maturity.

28. Although a possible alternative for bank financing, the corporate bond market remains severely underutilized, with the most recent local currency corporate bond issuance occurring in October 2012. In fact, corporate bonds outstanding declined to $0.7 billion (0.4% of GDP) in December 2013 from $1.1 billion (0.7% of GDP) in December 2012, continuing a trend that began in March 2011. The market remains highly concentrated—with the 15 largest issuers being responsible for all corporate bonds outstanding—and illiquid as illustrated by high bid–ask spreads (Table 1).

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20. As of November 2013. The actual size of the corporate bond market may be underrepresented as some bond issuance campaigns were not made public and were issued through private placements.

21. Although a significant shortening of the maturity of outstanding local currency corporate debt followed the global financial crisis, the 5–10 year maturity bracket has increased rapidly from 0% in September 2010 to 64.0% in December 2013. This progress was facilitated by the rather small overall volume.
Supply has been limited by the availability of directed credit from SOCBs. At the same time, investor appetite remains low due to depressed market conditions, elevated credit risk in the private sector, and a dearth of reliable credit information. Most corporate bonds are unrated as there are no domestic credit rating companies. Similarly, outstanding municipal bonds, which have a relatively long history in Viet Nam, represented only 0.3% of GDP at the end of 2012.

23 In terms of market structure, there are two stock exchanges. The Ho Chi Minh City Stock Exchange (HOSE) began operations in 2000 with just two listed companies. In 12 years, HOSE had grown to 308 listed stocks. The Hanoi Stock Exchange (HNX) opened in July 2005 with six listed companies and by end 2012 reported 396 listed stocks, 448 listed government bonds, 18 listed Treasury bills, and 132 registered over-the-counter stocks at the Unlisted Public Company Market. There were 105 securities companies and 47 fund management companies, with 1.3 million active and inactive investor accounts. One of the many challenges to address is the overall poor health of securities companies, with 70% of them reporting accumulated losses in the third quarter of 2012.

Table 1: Average Bid–Ask Spread of Local Currency Bonds (Basis Points)

<table>
<thead>
<tr>
<th></th>
<th>HKG</th>
<th>INO</th>
<th>IND</th>
<th>KOR</th>
<th>MAL</th>
<th>PHI</th>
<th>PRC</th>
<th>SIN</th>
<th>THA</th>
<th>VIE</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Government</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>On-the-run*</td>
<td>7.3</td>
<td>8.6</td>
<td>1.3</td>
<td>0.7</td>
<td>3.8</td>
<td>5.4</td>
<td>4.1</td>
<td>2.6</td>
<td>2.4</td>
<td>21.7</td>
<td>5.8</td>
</tr>
<tr>
<td>Off-the-run</td>
<td>8.0</td>
<td>13.6</td>
<td>7.4</td>
<td>1.3</td>
<td>9.0</td>
<td>16.8</td>
<td>6.0</td>
<td>4.3</td>
<td>5.4</td>
<td>40.0</td>
<td>11.2</td>
</tr>
<tr>
<td><strong>Corporate</strong></td>
<td>31.9</td>
<td>26.1</td>
<td>11.1</td>
<td>4.4</td>
<td>9.8</td>
<td>36.6</td>
<td>11.4</td>
<td>21.9</td>
<td>8.6</td>
<td>138.3</td>
<td>18.0</td>
</tr>
</tbody>
</table>

HKG = Hong Kong, China; INO = Indonesia; IND = India; KOR = Republic of Korea; MAL = Malaysia; PHI = Philippines; PRC = People’s Republic of China; SIN = Singapore; THA = Thailand; VIE = Viet Nam.

Notes: Results are from a survey with a limited number of responses (106 for government bonds and 72 for corporate bonds) and should be considered as indicative only. The bid–ask spreads for Indonesian Treasury bonds are expressed in terms of yields or basis points to make them comparable with bid–ask spreads in other Asian markets. Bid–ask spreads for government bonds are most often expressed in terms of “cents” in the Indonesian market.

* “On-the-run” refers to the most recent issue of bonds of a particular type and tenor.

b “Off-the-run” are bonds from prior issues.

c Data from 2012 survey.


Equity market. By reaching 25.2% of GDP in 2007, Viet Nam’s combined stock market capitalization far exceeded the government’s initial target of 10% by 2010. While most regional equity markets recovered quickly after the global financial crisis, Viet Nam has yet to reach this level again. A stock market capitalization of 21.1% of GDP in 2012—4 percentage points under the 2007 peak and lagging regional comparators—underscores its potential to catalyze future economic growth, particularly since newly issued equity can be leveraged (Figure 6).

24 The top 10 securities companies account for approximately 60% of market share. In the third quarter of 2012, 11 securities companies were under special scrutiny by the State Securities Commission, 3 were on the watch list, and several had started to withdraw from the market. There were about 10,000 foreign investor accounts on the stock market by 2013, over 1,000 of which belonged to institutional investors.

Footnote 19.

See, for instance, R. Levine and S. Zervos. 1998. Stock Markets, Banks, and Economic Growth. The American Economic Review. 88 (3). pp. 537–558. The authors estimated that an increase in stock market liquidity by one standard deviation at inception would have resulted in an 18% increase in GDP over the 18 year period of study.

The top 10 securities companies account for approximately 60% of market share. In the third quarter of 2012, 11 securities companies were under special scrutiny by the State Securities Commission, 3 were on the watch list, and several had started to withdraw from the market. There were about 10,000 foreign investor accounts on the stock market by 2013, over 1,000 of which belonged to institutional investors.
31. Many large state-owned enterprises (SOEs) have not yet been listed despite an “equitization” process that turned them into joint stock companies with limited liability (para. 61). This has resulted in a stock market that is dominated by a large number of small companies. Annual reports show that the 704 listed companies on the HOSE and HNX had a cumulative stock market capitalization of VND156 trillion ($7.5 billion) in December 2012 (Figure 7). While 535 of these listed companies had a stock market capitalization below $10 million, the top 10 accounted for nearly a third of total stock market capitalization. The number of newly listed companies at HNX has dropped significantly from 104 in 2010 to 14 in 2012. Moreover, when excluding Lam Thao Fertilizers and Chemicals JSC, the average market capitalization of companies newly listed on HNX in 2012 was, at $3 million, significantly lower than the average of $8.2 million in 2009–2011.

32. Insurance sector. Contractual savings, such as insurance and pensions, represent an emerging opportunity to provide an engine of demand for government bonds and other long-term financial instruments such as corporate bonds and infrastructure finance. Although the commercial insurance sector in Viet Nam is only 20 years old, it has developed rapidly in terms of premiums, products on offer, and diversity (Figure 8).

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25 While this has resulted in a marked reduction in the number of SOEs, for the remaining SOEs—many of them large in size, complex in operation, and weak in performance—reform has neither had any clear impacts on the reallocation of state resources nor created any big change in the state’s role in a market economy. Large general corporations (or conglomerates) have mostly converted into holding companies or, in a few cases, economic groups have only recently begun the transformation process.

26 At the time, the Unlisted Public Company Market accounted for 132 companies and a stock market capitalization of VND29 trillion ($1.4 billion).

27 Calculations are as of December 2012, excluding delisted companies.

28 Government bonds constituted 58% of the aggregate investment portfolio of life insurance companies in 2011.

29 In 2013, the insurance sector consisted of 12 life insurance companies, 29 nonlife companies, two reinsurance companies, and 12 insurance broker groups.
doubled between 2008 and 2012, driven by robust economic growth, the rising middle class, rapid urbanization with better access to insurance products, an expanding automobile industry, and improving awareness of the benefits of insurance products. Research indicates that such an increase in insurance penetration accelerates economic growth. However, premiums as a

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See, for instance, M. Arena. 2008. Does Insurance Market Activity Promote Economic Growth? A Cross-Country Study for Industrialized and Developing Countries. The Journal of Risk and Insurance. 75 (4). pp. 921–946. The author estimates that a standard deviation increase in total insurance premiums to GDP would increase real GDP per capita growth by 0.47% with even greater effects in countries at low to middle levels of development.
percentage of GDP remained rather stable and the insurance market appeared to be slowing down in the first half of 2013, with premiums increasing by merely 6.9% per year to D41 trillion ($2 billion). While insurance penetration rates around 1.4% of GDP are now comparable to that of Indonesia and the Philippines, they remain far below other EEA countries and the global average of 6.6% (Figure 9).  

![Figure 9: Insurance Penetration (% of GDP)](image)

GDP = gross domestic product.

33. Nearly all 12 life insurance companies in Viet Nam are 100% foreign-owned, financially sound, and well managed. The market is concentrated, with the top three players holding a combined market share of circa 80%. The most popular life insurance products are endowment policies, which attracted 67% of the segment’s total written premiums in 2012. In terms of new business premiums, the Ministry of Finance (MOF) reported market shares for endowment policies of 54% and for investment linked products of 41%, which shows that investment linked products are on the rise. Traditionally, life insurers relied on their network of around 220,000 insurance agents to distribute products across the country. Agents are still responsible for 98% of new business premium income, but many appear insufficiently trained to sell more sophisticated risk products such as income protection, disability insurance, and annuities. Although life insurance companies are recognizing the potential of bancassurance, its growth is reportedly constrained by a limit on commissions.

34. The highly concentrated and largely locally owned nonlife insurance sector exhibits a different profile. The average premium income for 2012 was D791 billion ($38 million). As the largest five local nonlife insurance companies captured a market share of 72% in 2012, most of the remaining nonlife

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31 In 2013, the insurance sector consisted of 12 life insurance companies, 29 nonlife companies, two reinsurance companies, and 12 insurance broker groups.

32 The government recently increased the minimum capital requirement for life insurers to D600 billion ($29 million)—twice the level for nonlife insurance—which would make it difficult for small and less efficient insurance companies to enter the market.

insurance companies operate at premium income levels too low to run an efficient and professional operation. Moreover, some companies which are 100% owned by a group are known to practice cash flow underwriting, which means a drive for business volume without regard for profitability. Further, potential commercial conflicts of interest may need to be addressed, as often both insured companies or agencies and insurance companies are owned and/or controlled by the government.

35. **Broad reforms are necessary to realize the insurance sector’s potential.** Insurance products that cater to all segments of society—including the low-income sector—should be supported by better regulation and supervision, and in the longer term, private insurance could also play a useful role in areas that are still considered to be fully in the public sector domain (Box 3). For instance, regulations must be strengthened to incorporate international standards, especially with regard to capitalization and reserves. In addition to reinforcing the Insurance Supervisory Agency (ISA) as described in para. 51, there is a need to adopt international accounting and financial reporting standards. Moreover, the purchase of compulsory insurance products, such as fire insurance, must be supported by effective enforcement mechanisms, and better regulation for professional liability insurance should be considered as well. In terms of risk management, the insurance sector does not yet make comprehensive use of actuarial experts and there is a shortage of qualified professionals. As a significant time lag is involved in training actuaries, this issue requires urgent attention.

36. **Social security system.** The Vietnam Social Security System (VSS) was established in 1947 and has grown rapidly in recent years. Reportedly, the number of insured people is about 15 million, with 10.5 million people contributing to the fund. Typically, governments rely on a three-pillar social security system that is: (i) government-run, (ii) employer-mandated, and (ii) employee voluntary. From this perspective, social security in Viet Nam could be considered underdeveloped as it relies almost exclusively on the first pillar. Further, the VSS is in danger of insolvency. The International Labour Organization projects that—assuming a constant coverage rate—the pension fund will be depleted by 2027. A combination of reforms, including raising the retirement age to 65 and equalizing the replacement rate between public and private sector workers, would delay this to 2052. Since only an estimated 20% of employees contribute to the pension scheme, it is essential to aim for more comprehensive coverage as well. Fund management needs to be improved. Most of the fund’s assets—valued at D221 trillion ($10.6 billion) in 2012—have been invested in government-guaranteed fixed income assets, including government and Vietnam Development Bank bonds, with the remaining quarter in bank deposits. This has produced unsatisfactory investment returns.

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34. Although smaller and largely foreign competitors are increasingly entering the market and gaining market share, the nonlife insurance market continues to be dominated by Bao Viet and PetroVietnam Insurance.


36. Some SOEs have begun divesting from noncore businesses, including insurance, in response to Decision No. 929/QD-TTg of 17 July 2012 of the Prime Minister approving the Scheme to Restructure State-Owned Enterprises, Focus on Economic Groups, Corporations for the Period 2011–2015. Ha Noi.

37. Interviews with market participants indicate that capital adequacy calculations for the Viet Nam subsidiaries of global insurance companies, which are based on Solvency II, are about 12 times higher than those for local insurance companies guided by Circular 125. This indicates that the crude approach used by the Circular is inappropriate and disadvantageous to global firms.

38. No actuarial society has been set up due to insufficient local qualified actuaries. There are only 11 fellows of the Society of Actuaries or Institute of Actuaries, four of which are local. While some universities offer some actuarial subjects in their insurance program, there is no formal actuary program.


40. Many businesses have neither signed labor contracts with workers, nor registered their payrolls with the Social Insurance agency. To dodge social insurance payments, it is a widespread practice to understated wages in labor contracts. Some companies have two separate payrolls, with one for tax payment purposes and the other for social insurance payments.
If these issues can be addressed, the VSS has the potential to become a significant and professional institutional investor. Strengthened investment fund and risk management with a more diversified portfolio would generate a higher average return at an acceptable risk. Voluntary pension schemes, which are to be piloted in the near future, can also play an important role in supplementing public pensions and would add to the domestic pool of capital available to invest in local currency bond and equity markets. A circular was issued in August 2013 to enable the provision of pension insurance products by life insurance companies under strict conditions.

Box 3: Health Insurance Reform—A Role for the Private Sector?

Despite rapidly expanding health insurance coverage and significant progress in overall health indicators, people have shouldered a heavy health care burden, with private expenditures increasing to 60% of total health cost by 2009. Especially problematic is the large share of out-of-pocket payments, with over 15% of the population spending more than 25% of their discretionary income on health. Recognizing the risk this poses for income poverty, the government declared its intention in the Health Insurance Law to implement universal health insurance through the Vietnam Social Security System by 2014.

Health Insurance Coverage
(% of the insured)

The government is considering significant legal amendments and a shift from voluntary to compulsory payments to further increase the coverage rate from 66.8% in 2012 to 70% by 2015 and 80% by 2020. This scheme would support free cover for the poor and ethnic people living in difficult areas, and up to 95% subsidized premiums for the slightly better off. At the same time, there are plans to increase insurance rates and, possibly, use part of examination and treatment fees to boost the health insurance fund. While recognizing that health care performance in Viet Nam has been impressive so far, it is important to monitor the impact and cost of these and future reforms carefully, and consider if eventually the private sector could provide this service more efficiently and effectively.

\[ a \] A recent study identified several other challenges for the public health insurance system, including complexities and ambiguities that are hindering universal coverage, hidden distorted incentives, unfamiliarity with the system, and a lack of financial stability.

\[ b \] The health insurance fund registered a surplus of nearly D12.9 trillion ($614 million) in 2012.

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37. If these issues can be addressed, the VSS has the potential to become a significant and professional institutional investor. Strengthened investment fund and risk management with a more diversified portfolio would generate a higher average return at an acceptable risk. Voluntary pension schemes, which are to be piloted in the near future, can also play an important role in supplementing public pensions and would add to the domestic pool of capital available to invest in local currency bond and equity markets. A circular was issued in August 2013 to enable the provision of pension insurance products by life insurance companies under strict conditions.\[41\]

\[41\] These include (i) a minimum equity of D1 trillion ($47.4 million), (ii) a minimum liquidity ratio of D300 billion ($14.2 million), (iii) a minimum voluntary pension fund of D200 billion ($9.5 million), adequate information technology
38. **Microfinance.** Viet Nam has one of the most extensive microcredit systems in the world, although contrary to other countries with deep microfinance penetration such as Bangladesh and India, microfinance institutions (MFIs) tend to be heavily subsidized and characterized by government control. In fact, the government uses a dual approach that is both market-based and state-driven to ease the financing constraints of poor and rural households. Two dominant state-owned financial institutions—the heavily subsidized nonprofit Vietnam Bank for Social Policies (VBSP) and the more market-oriented Vietnam Bank for Agriculture and Rural Development—coexist with 1,130 member-based People's Credit Funds (PCFs), two licensed MFIs, and 50 semiformal MFIs that are mainly supported by mass organizations and donors (Table 2). Viet Nam's microfinance sector stands out for its gender orientation with 94% of active microfinance clients in 2008 being women. A survey reports that over 85% of respondents said it is not more difficult for women entrepreneurs to access credit than for men.

### Table 2: Microfinance Lending in 2013

<table>
<thead>
<tr>
<th>Institution</th>
<th>Number of Clients (millions)</th>
<th>Loans Outstanding ($ million)</th>
<th>Average Loan Size ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>VBSP</td>
<td>7.0</td>
<td>5,350</td>
<td>764</td>
</tr>
<tr>
<td>VBARD</td>
<td>1.5</td>
<td>1,390</td>
<td>927</td>
</tr>
<tr>
<td>PCFs</td>
<td>1.1</td>
<td>1,294</td>
<td>1,176</td>
</tr>
<tr>
<td>MFIs</td>
<td>0.8</td>
<td>189</td>
<td>236</td>
</tr>
</tbody>
</table>


Notes: Based on the SBV definition of microfinance lending of an amount up to D30 million ($1,423). In 2012, VBSP started reporting the number of borrowers based on the household client, which may have several borrowing members. MFIs include both formal (licensed) and semiformal (unlicensed) institutions involved in microfinance services.


39. However, a more nuanced assessment reveals that the microfinance market is in need of reform. VBSP’s dependence on public resources and its focus on social policy lending resulted in a growing fiscal burden, an emphasis on credit delivery instead of providing other financial services, and an uneven playing field. Moreover, a recent Asia-Pacific Economic Cooperation study reported that rural areas—where 94% of the absolute poor reside—and ethnic minorities remain underserved by the formal microfinance sector. In part, the effectiveness of PCFs, which are financial cooperatives,

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42. Interest rate subsidies cost the government an estimated $200 million annually.

43. Mass organizations, such as the Vietnam Farmer’s Union, play an important role in assisting microfinance delivery of state-owned or -directed institutions. For instance, the Vietnam Woman’s Union administers about half of VBSP loans and collects the interest. While these mass organizations are affiliated with the government, they tend to operate mostly independently. According to the Vietnam Microfinance Working Group, the average return on assets and charged fees and interest of Vietnamese MFIs (excluding VBSP and CCF) are 3.8% and 18.1%, respectively. This compares favorably to Asia and Pacific comparators (excluding the People’s Republic of China) with 2.8% and 34.5%, respectively, as MFIs from Viet Nam transfer a substantial portion of their cost to other organizations.


is affected by the Central People’s Credit Fund (CCF). The government ownership of the CCF, which was recently converted into the Cooperative Bank of Vietnam, is unique as similar apex institutions in other countries tend to be wholly owned and managed by member primary cooperatives to support self-help, mutual assistance, and democratic autonomy in the operation of their cooperatives.  

Under the government’s control, close to 50% of the CCF’s loan portfolio has been granted to recipients outside of the PCF network, with loans to SOEs, small and medium-sized enterprises (SMEs), and entities and individuals who are not members.

Recently issued decisions still require financial institutions to cap VND short-term (below 1 year) lending interest rates to certain sectors—rural development and agriculture, SMEs, exporters, supported industries, and high technology—at 8% per year (9% by PCFs and MFIs); and to cap interest rates for VND deposits from 1–6 months at 6% per year (6.5% by PCFs and MFIs). This is not in line with international best practices for microfinance and could hamper outreach to clients, as it threatens the sustainability of microfinance operations of MFIs and PCFs, which bear high operational costs. As such, it has a negative impact on the implementation of ADB’s ongoing Microfinance Development Program calling for market-oriented microfinance in line with the National Microfinance Development Strategy. The Vietnam Microfinance Working Group has called for a removal or significant increase of the interest rate cap to enable cost recovery and an expansion of services.

The Credit Institutions Law, which took effect in January 2011, for the first time recognizes MFIs as official credit institutions subject to supervision by the SBV. The law includes improved provisions for creating and regulating MFIs, PCFs, cooperative banks, and for supervising policy banks. For instance, the Credit Institutions Law includes licensing and reporting requirements and mandates the SBV to impose prudential norms over financial institutions engaged in microfinance. However, many of the necessary implementation rules and regulations are still being drafted. It is expected that the formalization and licensing of MFIs will eventually improve their governance structure and strengthen their capacity to offer a wider range of financial services.

C. Core Sector Issues

Historically, financial sector development appears to have taken place more along product lines rather than through a holistic view of capital market development. This has contributed to a patchwork of markets as well as the creation of formal systems and trading models for individual financial products. For instance, systems for issuing Treasury bills and bonds differ, and the secondary market trading channels have been, until recently, completely segregated. Specifically, bond markets employed an equity exchange-based platform, while money markets traded on an over-the-counter basis. Meanwhile, repurchase agreements, which are

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46. This is a basic cooperative tenet advocated by the International Co-operative Alliance in its governing principles of a cooperative. The International Co-operative Alliance. 1995. Statement on the Co-operative Identity. Manchester.


48. Under the Credit Institutions Law, MFIs and cooperative credit institutions comprising cooperative banks and PCFs are placed under the supervision and regulation of the SBV. The Credit Institutions Law also covers policy banks (including the VBSP), which will continue to implement state socioeconomic policies on a not-for-profit basis and will remain under the organizational and operational control of the government. However, all policy banks are now required to implement internal controls and audits; develop and issue internal procedures applicable to their operations; and adopt statistical, operational, and payment activity reports in accordance with SBV stipulations.

49. In August 2012, Treasury notes started to trade on the HNX bond market.
both security market transactions and money market funding instruments, are subject to multiple layers of supervision. Laws and regulations, as well as reforms, tend to be similarly developed and implemented by the various regulatory bodies and may benefit from more extensive coordination and collaboration. Efforts to improve coordination are ongoing, but can sometimes be bureaucratic, with official guidelines dictating the flow of information or setting responsibilities and narrow deliverables. Revisions to existing regulations are sometimes enacted via new circulars that partially overlap with, instead of replacing, earlier issuances. As a result, understanding and applying regulatory standards requires reading an aggregation of issuances, which reduces legal clarity.

43. **Embracing market principles.** Existing or newly introduced state interventions can prevent markets from functioning effectively and efficiently, and run counter to the government’s efforts to transform Viet Nam from a centrally planned economy to a market-oriented system. At times, such interventions in the financial sector may be justified by economic shocks, the need for proper sequencing, or other reasons. However, they can and often do have direct or indirect repercussions in other segments of the economy. Hence, it is important to analyze and monitor the positive and negative impacts of such interventions with the objective of limiting such repercussions and phasing out interventions at an appropriate time.

44. For example, in 2008, a rigid mechanism was introduced to manage dong-denominated base interest rates: credit institutions supervised by the SBV were to set their rates for deposit taking and lending at or below 150% of the base interest rate. A similar cap was set for interbank transactions in the same year. The base interest rate therefore had two functions: (i) providing general guidance to market participants in setting their own interest rates; and (ii) setting a ceiling for market lending rates. This ceiling rate created serious structural impediments for financial sector development. For instance, it limited debt issuance to short-term maturities as potential investors were unable to obtain adequate returns for assumed risks. Moreover, the credit discipline mechanism broke down as rates paid by less creditworthy institutions in the interbank money markets tended to bunch at the ceiling rate.

45. Circular 16 was repealed on 14 April 2010 for lending to clients, and the base interest rate has not been updated since November 2010. Moreover, the interbank market cap was repealed in 2012, although at that time it was no longer considered a binding constraint due to increased liquidity and excess reserve levels. These decisions were likely facilitated by falling global interest rates, which reduced the impact of removing the ceiling rates. Similar lending rate ceilings, particularly for priority sectors, and deposit rate ceilings continue to exist, but have recently been lowered (para. 40). However, it remains to be seen how the authorities would respond to a rising rate environment.

46. **Independence of the central bank.** Typically, central banks target low and stable inflation as their primary objective, with the independence to implement an appropriate monetary policy based on interest rates. However, the SBV has been guided by multiple considerations and mandates. The 2010 Law on the SBV stipulates that the key objectives of monetary policy are to stabilize the currency and

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50 Decision No. 16/2008/QD-NHNN of 16 May 2008 of the Governor of the State Bank of Vietnam on a Mechanism to Adjust the Basic Interest Rate in Vietnamese Dongs. Ha Noi. The SBV applied this dong-denominated “base interest rate” management mechanism on the basis of civil law, the SBV Law, and money market movements. The tenor to which this rate was intended to apply was unspecified for either secured or unsecured lending. Refer to the following website for a more detailed overview: https://sites.google.com/site/hoangcounsel/banker/interest-rate/baseinterestrate


52 Of total interbank turnover in 2012, 77% was undertaken for tenors of 1 week or less, largely unchanged from March 2009.

53 Circular No. 21/2012/TT-NHNN of 16 June 2012 of the Governor of the State Bank of Vietnam Regulating the Lending and Borrowing Activities; and Repo of Valuable Papers among Credit Institutions and Foreign Bank Branches. Ha Noi.
to control inflation, putting more emphasis on these objectives than previously. In addition, the law enhanced the central bank’s autonomy and accountability in formulating and implementing monetary policy. However, it treats the central bank as a ministerial-level agency of the government, and it may be necessary to further insulate central bank policies from potential pressure from government agencies and large state-owned commercial banks (SOCBs).\textsuperscript{54} In the long run, the government would also need to further increase the SBV’s operational autonomy and technical capacity.

47. Up to very recently, the SBV’s modality for achieving price stability was limited to controlling the money supply based on government approvals. Specifically, the SBV was tethered to predetermined additions and/or reductions to the money supply, with limited ability to independently process appropriate midyear corrections, which resulted in large short-term interest rate fluctuations.\textsuperscript{55} While this may have been appropriate in the past, monetary policy increasingly requires a flexible approach as Viet Nam’s financial sector has become more complex and the market has become more volatile and unpredictable (Figure 10). In a positive development, a new decree instead requires the central bank to propose annual inflation targets for government approval, and implement monetary policy through tools such as interest and exchange rates, reserve requirements, and open market operations.\textsuperscript{56}

48. Macroprudential policy framework underdeveloped. There is a need to build a well-articulated framework for macroprudential policy to gauge and manage overall financial system risks and to improve resilience to shocks. In a small open economy like Viet Nam, these risks are not

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easily contained by traditional monetary policy but require more targeted prudential intervention that acts more directly to constrain excessive credit and leverage, as well as overexposure to aggregate shocks such as changes in exchange rates and asset prices. Given the high degree of interconnectedness within the financial system and between banks and the enterprise sector, it is therefore important to prepare the ground for adequate systemic risk monitoring and contemplate the use of adequate macroprudential tools. The SBV’s limited role, to date, in addressing these systemic risks is partially explained by a lack of clear assignment of responsibility for financial stability. Up to very recently, there was no institution responsible for gauging and managing overall financial system risks and no legal framework for macroprudential policy (para. 90). Hence, the availability of macroprudential data remains limited.

49. **Narrow investor base.** While the growth in Viet Nam’s financial markets, and in particular its stock market, has been remarkable, the investor base is not sufficiently diversified or seasoned as the public’s understanding of economic, financial, and legal principles tends to be low. Equity market participants can broadly be categorized into two primary groups: foreign funds and less sophisticated local retail investors.\(^\text{57}\) While a nascent professional fund management industry is developing, the investment strategy of these organizations often mirrors the outsized risk taking of the average retail investor.\(^\text{58}\) As a result, the equity market can be quite volatile, which inhibits its ability to serve as a stable source of long-term intermediation.\(^\text{59}\) Moreover, capital market participants are insufficiently supported by sound fundamental analysis that would, for example, discourage entities from utilizing equity offerings without a clear strategy to employ the additional funds. Sufficient institutional participation would have a positive impact on the quality of information disclosure, corporate governance, and protection of shareholders against abusive practices of insiders.

50. **Need to strengthen investor and consumer protection.** Given the young age of capital markets in Viet Nam, it is not surprising that investor and consumer protection mechanisms have not yet fully matured. This has, over time, contributed to a certain disregard for regulations and standards by some companies. For instance, Viet Nam ranked 157 out of 189 countries on the Strength of Investor Protection Index according to Doing Business 2014, which is problematic as such mechanisms are essential pillars for investor confidence.\(^\text{60}\) A recent study confirmed that corporate governance practices in publicly listed companies in Viet Nam fall below expectations.\(^\text{61}\) For instance, financial statements are often released late, directors dealing in company shares are not required to report these dealings within 3 business days, and supervisory boards in listed companies do not consistently monitor the board of directors and senior management. The report also recommended that regulators encourage the establishment of an institute that provides

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\(^{57}\) According to the State Securities Commission (SSC), approximately two-thirds of total transaction volume on the Ho Chi Minh City Stock Exchange (HOSE) is from foreign investors.

\(^{58}\) In 2012, 23 of 47 fund management companies reported incurring losses.

\(^{59}\) Research by Goldman Sachs confirms that markets that have a high reliance on small retail investors, without the stabilizing effect of local institutional investors, exhibit high volatility.

\(^{60}\) The Strength of Investor Protection Index covers three dimensions with indices ranging from 0 to 10; higher values indicate greater disclosure, greater liability of directors, greater powers of shareholders to challenge transactions, and better investor protection. The overall Viet Nam score of 3.3 was based on 7 for transparency of transactions (Extent of Disclosure Index), 1 for liability for self-dealing (Extent of Director Liability Index), and 2 for shareholders’ ability to sue officers and directors for misconduct (Ease of Shareholder Suits Index). The corresponding average East Asia and Pacific scores were 5.3 (overall), 5 (Extent of Disclosure), 5 (Extent of Director Liability), and 6 (Ease of Shareholder Suits). For more details, see World Bank. 2013. Ease of Doing Business in Vietnam. Washington, DC.

\(^{61}\) ADB. 2013. ASEAN Corporate Governance Scorecard: Country Reports and Assessments 2012–2013. Manila. A revised Code of Corporate Governance (Circular 121/2012/TT-BTC of 26 July 2012), applicable to all public companies and covering areas such as shareholder rights and obligations, Boards of Directors, Supervisory Boards, and conflicts of interest, took effect on 17 September 2012. The impact of this regulatory change may not have been fully reflected in the results of the study.
corporate governance training to directors to facilitate compliance with the new corporate governance code and its stricter requirements for board independence. The study was positive, among others, about disclosure of the nature and value of material related-party transactions and disclosure of the identity of major shareholders. Further, strengthening of consumer protection mechanisms remains essential, although some progress was recently made with the introduction of an insurance policyholder protection fund, the Deposit Insurance Law of 2011, and the more general Consumer Rights Protection Law of 2010.\(^{62}\)

51. **Supervision of financial markets still developing.** Supervisory agencies tend to have limited enforcement capabilities and insufficient resources, and lack a necessary degree of independence. In the banking sector, this is made worse by the fragmentation of the regulatory and supervisory architecture over several departments in the SBV and the MOF, with no single agency being responsible for monitoring systemic risks (para. 48). In addition, regulatory response times can be slow and inflexible compared to the dynamic nature of the private sector. To strengthen investor confidence, fledgling investor and consumer protection mechanisms will need to be supported by effective market regulators and supervisors capable of conducting high-quality inspection, investigation, surveillance, and enforcement. As a positive sign of progress, the State Securities Commission (SSC) signed Appendix A of the Memorandum of Understanding of the International Organization of Securities Commissions on 18 September 2013, which will support its supervision of the securities market. Nevertheless, supervisory authorities, such as the SBV, the SSC, and the MOF’s ISA, will need to be further strengthened and supported by focused capacity building to effectively fulfill their mandates.\(^{63}\) Moreover, professional organizations charged with self-regulatory functions, such as accountants and auditors, are too few in number and require additional training to supplement the regulatory process. The role of various self-regulatory organizations (SROs) and industry trade groups should be expanded and clarified with regard to surveillance and monitoring.

52. For example, while industry stakeholders generally support ISA’s efforts, regulatory interventions are seen as micromanaging instead of guiding the industry. To bolster its effectiveness, ISA may require a greater degree of separation from the MOF, with independent funding sources and more flexibility in terms of human resource management. More clarity with respect to guidelines, such as the treatment of quarterly reserve calculations, is also necessary and supervision should be based on principles rather than compliance. Moreover, ISA’s technical capacity will need to be enhanced, and information and data gathering should be automated to provide for prompt analysis and the development of early warning tests, thereby freeing analysts’ time for more value-added activities. Compounding this problem, the Insurance Association suffers from a lack of capacity and plays a limited role in advancing the needs of the sector.

53. **International standards not fully reflected in financial reporting.** Viet Nam has not yet completely embraced international sound practices on a number of fronts, which impacts the quality of its financial infrastructure. For instance, Vietnamese Accounting Standards (VAS) are not

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\(^{62}\) An important step was taken in July 2011 with the establishment of a policyholder protection fund to protect insured persons against insolvency or bankruptcy of the insurer. A share of premium revenue retained from primary insurance contracts, not exceeding 0.3%, will be allocated until the fund amounts to 5% of total assets of a general insurer or 3% of a life insurer. To ensure their solvency, insurers must also build a reserve fund funded by 5% of after-tax profits. See also Decision No. 59/2010/QH12 of 17 November 2010 of the National Assembly approving the Consumer Rights Protection Law, and Decision No. 06/2012/QH13 of 18 June 2012 of the National Assembly approving the Deposit Insurance Law. Ha Noi.

\(^{63}\) Capacity constraints in supervisory authorities tend to mirror skill gaps that are present in ministries, SBV, and other regulatory agencies as the public sector, as a whole, finds it difficult to offer the remuneration packages necessary to attract and retain high-quality personnel. Moreover, training resources provided by development partners are often allocated to expensive standalone sessions abroad rather than utilizing and building more efficient and sustainable training programs in Viet Nam.
fully aligned with International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS). This poses significant challenges to the further development of financial markets.\(^{64}\) First and foremost, the Accounting Law imposes a cost basis of valuation to tangible fixed assets, investment property, intangible assets, certain financial instruments, and inventories. This guidance conflicts with IAS and IFRS, which prescribe a concept of fair value. Without mark-to-market, key incentives are missing, which will continue to constrain the development of much-needed financial discipline, including risk mitigation strategies and risk management skills.

54. Moreover, Articles 10(3) and 29(4) of the Accounting Law require the MOF to stipulate detailed presentation rules for financial statements, and guide the application of suitable management accounting for each field of activity.\(^{65}\) Designing separate cost and management accounting systems (i) runs counter to the purpose of having an international standard, (ii) is a labor-intensive task that diverts scarce resources from more productive efforts to develop capacity and enforce compliance to accounting standards, and (iii) may provide opportunities for rent seeking. Discussions with industry stakeholders seem to indicate that existing circular-based accounting practices are deeply embedded in the industry and bureaucracy, which could pose a challenge to fundamental reform toward accounting principles. Stakeholders have stated that there is little externally generated motivation to revamp this system for a variety of reasons. For example, local operations of international manufacturing conglomerates are serviced by accounting firms that produce the necessary IFRS-compliant financial statements as an add-on to those prepared in accordance with local standards. Finally, the overall quality of the more than 7,000 professional accountants from Viet Nam is generally in need of improvement, and poses an additional challenge to the country’s convergence toward international standards.\(^{66}\)

55. **Unquantified risks in clearing and settlement.** The Vietnam Securities Depository (VSD), which was created in May 2006, has taken over all registration, depository, clearing, and settlement functions from HOSE and the HNX for listed securities.\(^{67}\) Other responsibilities include allocating and managing local securities codes, allocating International Securities Identification Numbers, processing corporate actions, managing a settlement compensation fund, acting as a dividend and coupon payment agent, and issuing trading codes for foreign investors.\(^{68}\) Although this

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\(^{64}\) Differences between the 26 VAS that were implemented in 2001-2006 and IAS can be traced back to the adoption of IAS published in the 1990s and early 2000s, and the non-adoption of recent IAS/IFRS (e.g., impairment and fair value standards, and accounting standard on financial instruments). For a comprehensive gap analysis, see: http://www.ccsenet.org/journal/index.php/ijbm/article/view/15097

\(^{65}\) Fields of activity would include, for instance, credit institutions, insurance companies, securities companies, and fund management agencies.

\(^{66}\) See http://www.ccsenet.org/journal/index.php/ijbm/article/view/15097

\(^{67}\) All securities to be registered at the VSD—shares, corporate bonds, treasury bills, government-guaranteed bonds, municipal bonds, government bonds, corporate bonds guaranteed by the government, fund certificates that have been listed/registered for trading at the stock exchanges, and shares/bonds of unlisted public companies—are transferred by book entry. The VSD records and manages information about ownership and other rights of securities owners. Clients open depository accounts at depository members to have their securities deposited, and depository members open depository accounts at the VSD to redeposit their clients’ securities. Clients have to work with depository members where they opened their account to get securities consigned, withdrawn, transferred, and pledged. Securities that are deposited at depository members remain clients’ assets and are managed separately from the assets of these depository members. A similar segregation takes place for securities deposited at the VSD by depository members. Settlement is carried out following a delivery-versus-payment principle, with securities delivery at the VSD and cash transfer at the Bank for Investment and Development of Vietnam being carried out simultaneously. Using multilateral netting, dong-denominated bonds formally settle on a T+1 cycle—although settlement in practice takes longer as over-the-counter trades have been negotiated and agreed at an earlier date (see para. 27)—and shares and fund certificates settle on a T+3 cycle. Ideally, the duration between actual bond trades and registration of these trades in the VSD is standardized and as short as possible to provide better pricing information and reduce settlement risk.

\(^{68}\) For a full overview of VSD functions, see Decision No. 1393/QD–BTC of 4 June 2009 of the Ministry of Finance on the
Centralization contributes to increased efficiency and failed trades have been rare, participants are exposed to elevated risk as the VSD appears to have assumed some functions of a central clearing counterparty (CCP) without the necessary strong capital base and risk management systems.

56. For example, a 2011 consultant report identified a number of operational risks, including a lack of legal certainty regarding how a defaulting broker or bank would be handled. There is an absence of case law in Viet Nam covering defaults, and the courts are unfamiliar with technical issues such as netting and finality. In addition, the bank used to settle the cash leg of securities trades (on a net basis) is not the SBV but the Bank for Investment and Development of Vietnam (BIDV), which is a commercial bank. This creates counterparty credit risk, as the BIDV approaches any payment failure on a commercial basis, and it provides an unfair advantage by providing the BIDV with a comprehensive and singular view of bond market activity.

57. To facilitate “unanticipated” interday credit needs of participants, the VSD maintains a settlement support fund. However, this fund has been used systematically to force delivery versus payment by extending credit for up to 5 days to participants. While this may be acceptable when supported by effective risk management controls—such as sufficient collateral, limits, and shorter credit periods—the VSD provides credit without collateral. It also appears that the fund has been utilized excessively in terms of outstanding amount and duration, although some regulatory progress seems to have been made since.  

58. Some risks could be mitigated by legal opinions based on thorough studies or by strengthening laws or regulations. Default preparedness and coordination procedures among stakeholders could also be improved. Moreover, Viet Nam could benefit from evaluating the benefits and costs of establishing a separate legal entity with specific CCP functionalities, strong risk management systems, and sufficient capital. In fact, the feasibility of such a CCP is currently being investigated. In addition, while listed securities must be immobilized in the VSD before being traded, Thomas Murray notes that settlement and custody by physical procedures still remains the norm for all other nonlisted securities, with the consequent operational and counterparty risk exposures. Finally, corporate governance of the VSD may need to be further reviewed as broad user and customer participation seems to be lacking. Ideally, regulations allow exchanges, central security depositories, and similar institutions to be fully transparent about their financial position, but it appears that the VSD does not publicly disclose its financial statements.

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69 In a worst-case scenario, a single participant could obtain credit for D125 billion, a significant share of the fund, before beginning to pay back. Reportedly, the credit period was sometimes extended beyond the formal limit of 5 days. The VSD introduced new regulations in June 2012 on the cancellation of trades related to a shortfall in funds that cannot be covered by the settlement fund or a loan from the settlement bank. The VSD also announced its intention in November 2012 to control settlement failures by enhancing regulations in relation to contribution to and borrowing from the settlement compensation fund by its members, and applicable penalties.


71 http://www.thomasmurray.com/countries-depositories/Vietnam_VSD.html

72 The consultant noted that VSD’s financial resources appeared to be quite limited given the absence of formal guarantees from the state or users.
A. Government Sector Strategy, Policy, and Plans

59. This section summarizes the government’s strategy and plans for developing the financial sector, which exhibit a pattern of broad-based reforms. Key elements of its strategic reforms over the past decade are highlighted, along with a description of relevant strategies up to 2020.

60. **Building market foundations.** Viet Nam’s financial sector reforms must be seen in the historical context of a fundamental transition from a centrally planned economy toward a more market-oriented system. In the initial years of this transition, a broad range of policy reforms was launched that focused on raising the efficiency of the enterprise sector, boosting agricultural production, opening up the economy to foreign investment and trade, and reforming the government.\[73\] The government began laying the foundation for capital market development as well.

61. The enactment of the Securities Law in 2007— together with a modernization of the Investment Law and Enterprises Law in 2005—established a cohesive legal framework for the development, regulation, and supervision of capital markets.\[74\] The law introduced the concept of public companies, which fall under SSC supervision and are subject to continuous disclosure. The government also accelerated the equitization process of SOEs, which peaked above 700 in 2005 before falling back to six in 2011 and was seen as a major driving force behind the rapid expansion of the equity markets.\[75\] Recently, the government attempted to rejuvenate the equitization process by strengthening state firms with the intent of equitizing, or partially privatizing, more SOEs and sharply reducing their number to 690 by 2015 and 200 by 2020. Progress is being made toward restructuring large SOEs, albeit slowly due to a weak external environment, technical complexity of reform, interministerial coordination and oversight, and political economy issues. In September 2013, about 55% of State Economic Groups and General Corporations had prepared approved restructuring plans, but it is still premature to assess their implementation.

62. The government has also launched initiatives to improve market disclosure, streamline the licensing regime and prudential standards, and prevent market misconduct. Basic financial infrastructure, including stock exchanges and the VSD, was established in this period as well.\[76\] Subsequent reforms included, among others, amendments in the Credit Institutions Law, enhanced supervision by SBV’s Banking Supervisory Agency and the SSC, linked automated trading

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\[74\] Based on the Securities Law, the SSC regulates HNX, HOSE, VSD, securities companies, fund management companies, and public companies.

\[75\] Equitization is the process of transforming an SOE into a joint stock company, although it does not always equal privatization. A 2011 HOSE presentation categorized the approximately 4,000 public companies as (i) listed at HOSE (7%), (ii) listed at HNX (9%), (iii) unlisted (3%), or (iv) equitized but not registered (81%).

\[76\] The VSD was established in 2006 and made responsible for clearing and settlement of securities transactions. Moreover, all public companies’ securities were to be deposited and cleared through the VSD.
systems for the stock exchanges, the establishment of SROs, and efforts to encourage broadened participation of foreign and local investors. Moreover, several laws and regulations were amended to more closely adhere to international standards and sound practices, for instance, in the area of corporate disclosure.77

63. **Financial sector strategy.** Despite these achievements, Viet Nam needs to further reshape its financial sector to support the ambitious long-term objectives of the Socio-Economic Development Plan (SEDP). To drive these reforms, the government has adopted an overarching financial sector strategy designed to support the achievement of the recently approved plan for economic restructuring in the period 2013–2020, and ultimately the SEDP.78

64. The Financial Strategy until 2020 was approved in April 2012.79 It aims at (i) building a healthy financial system; (ii) ensuring financial security; (iii) stabilizing the economy through monetary and fiscal policies; (iv) creating sufficient conditions to boost economic growth associated with reforming the growth model and restructuring the national economy; (v) adequately addressing social security–related issues; (vi) effectively and fairly mobilizing, managing, allocating, and utilizing financial resources; (vii) implementing synchronous and comprehensive administrative reforms; and (viii) ensuring effectiveness and validity in financial management and supervision.

65. The areas covered by the Financial Strategy are somewhat broader than one might expect. Proposed measures include, among others, (i) strengthening financial institutions, (ii) tax reform (including tax collection policies for land and natural resources), (iii) increased public spending on human development, (iv) ensuring the effectiveness of state budget–funded investment, (v) salary reform for public servants, (vi) improving the management of national reserves, (vii) strengthened public financial management (PFM), (viii) restructuring SOEs, (ix) reforming macrofinancial supervisory approaches, (x) enhancing the structure of the securities market, and (xi) improving supervision of the financial industry and corporate sector. The Financial Strategy includes specific targets and is supported by a detailed action plan consisting of 82 projects, and several industry–specific strategies (Box 4). The government has started with the implementation of the Financial Strategy until 2020 and related industry-specific strategies, some of which are described in subsequent sections.

66. **Banking sector.** The government would benefit from developing a long-term strategy for the banking sector, similar to the major subsector strategies up to 2020 described in subsequent sections. A more specific credit institutions restructuring plan for the period 2011–2015 was approved in March 2012, with an emphasis on restoring the financial soundness and operational capacity of Vietnamese banks.80 The road map aims at enhancing the leading role of SOCBs in the banking sector by promoting their continued “equitization,” while retaining a measure of government control, and creating one or two SOCBs that can compete with regional banks by 2015.81 Joint stock commercial banks (JSCBs),

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77 To achieve greater market transparency, the MOF issued Circular Number 9 in January 2010, which requires information disclosure from both listed and unlisted public companies. In addition, the Securities Law was amended in November 2010 to improve disclosure of public companies.
78 Decision 339/QĐ-TTg of 19 February 2013 of the Prime Minister approving a Scheme of Overall Restructuring Tied to Economic Growth Pattern Transformation Towards Improving the Quality, Efficiency and Competitiveness in the Period 2013–2020. Ha Noi.
80 Decision No. 254/QĐ-TTg of 1 March 2012 of the Prime Minister approving the Scheme to Restructure the System of Credit Institutions during the period 2011–2015. Ha Noi.
81 Other measures for SOCBs include (i) gradually reducing loan-to-deposit ratios to below 90% by 2015, (ii) bringing bad debt under the 3% threshold based on VAS, (iii) meeting Basel II capital adequacy standards by 2015 through issuance of new shares and funds from the government, and (iv) diversifying means for raising capital.
Box 4: Selected Targets of the Financial Strategy until 2020

- Increase the share of gross national investment to about 33.5%–35% of gross domestic product (GDP) for the period 2011–2015.
- Increase total revenues from taxes and fees to 22%–23% of GDP for the period 2011–2015 and 21%–22% of GDP for the period 2016–2020, with domestic revenue collection (excluding crude oil) increasing to over 70% of total state budget revenues by 2015 and 80% of total state budget revenues by 2020.
- Increasing the value of stock market capitalization to 50% of GDP in 2015 and 70% in 2020.
- Raising outstanding debts in the bond market to 30% of GDP in 2020.
- Lifting total revenues of the insurance industry to 2%–3% of GDP in 2015 and 3%–4% of GDP in 2020.
- Reducing the state budget deficit to below 4.5% of GDP in 2015 (including government bonds) and 4% of GDP during the period 2016–2020.
- Ensuring public debt (including government debt, government-sponsored debt, and local municipal debt) does not exceed 65% of GDP, foreign debt does not exceed 50% of GDP, and government debt does not exceed 55% of GDP.
- Increasing total national reserves to 0.8%–1% of GDP by 2015 and 1.5% of GDP by 2020.


finance companies, and financial leasing will be categorized into “healthy,” “temporarily illiquid,” or “weak” groups, and treated accordingly. For instance, the weak group will be closely supervised by the SBV and encouraged to merge or consolidate. The road map includes proposals to strengthen PCFs, microfinance institutions (MFIs), and foreign credit institutions as well. Foreign ownership ratios would be increased, particularly for weaker JSCBs (para. 71). A high-level interagency steering committee was created to implement the bank restructuring process, including resolving nonperforming loans (NPLs). Among the nine credit institutions restructured in phase 1 of the road map, eight weak banks have already been restructured or merged and one is expected to be purchased by a foreign bank in 2014. The SBV has indicated that additional 6–7 banks would undergo restructuring through merger or acquisition (Figure 11).

67. The Vietnam Asset Management Company (VAMC) was created on 9 July 2013 under the direct control of the SBV. The VAMC’s objectives include resolving bad debts and stimulating credit growth; it is responsible for the purchase, recovery, and restructuring of bad debt. Specifically, banks with NPLs over 3% will be required to sell their collateralized bad debt to the VAMC—at either book value in exchange for bonds or at market value in exchange for other financing sources—until this requirement is met. The VAMC will recover and/or restructure this debt, put the collateral up for sale, and is entitled to a percentage of the proceeds. The SBV–guaranteed special bonds with zero coupon and maturities up to 5 years received in exchange can be used as collateral for SBV refinancing, but must be written off by 20% each year. If the bad debt cannot be sold after 5 years, banks will return the bonds to the VAMC in exchange for the bad debt, which would give the transaction the characteristics of a repurchase agreement without title transfer, with the loss being covered by these provisions. Hence, the scheme effectively gives banks more time to write off their bad debt.

68. The VAMC has stated that it will conduct debt reclassification after purchasing bad debts, and—in collaboration with credit institutions and borrowers—reassess debt quality to identify measures to support a prompt recovery of the borrower. If enterprises cannot recover
or self-restructure, only then will the accounts be liquidated or sold to investors. In effect, the intermediate objective of purchasing NPLs would be to support the gradual recovery of the enterprises-borrowers rather than a robust effort to divest them of problem assets in the most efficient and cost-effective manner. By the end of 2013, the VAMC had purchased the equivalent of D39 trillion ($1.9 billion) in bad debts, or about 1.1% of all outstanding loans, from 35 banks. It plans to purchase roughly D70 trillion–D100 trillion ($3.3 billion–$4.7 billion) of bad debts in 2014, although purchases in the first quarter of 2014 have fallen far below its target. By April 2014, the VAMC had recovered more than D300 billion ($14.3 million) worth of debts. In a positive development, the VAMC is considering to propose to the SBV an increase in its charter capital to D2,000 billion to facilitate the sale of bad debt, but it is unclear how the SBV would respond to such a request.

69. International investors have expressed concerns over this process, including VAMC’s limited capital base (D500 billion or $24 million), questionable capacity, lack of independence, and intention to purchase bad debt at book value. Moreover, Fitch Ratings warned that the VAMC may not be able to tackle many of the asset quality issues in the near term due to a lack of clarity in some aspects of its operations and because the effectiveness of regulation to strengthen the accuracy and transparency of the sector’s asset quality problems has been delayed (Box 1). The Fitch report also notes that the VAMC could remove bad debt from banks but not their losses. These losses, coupled with continuing earnings pressure and residual asset quality problems, underscore a continuing need
for fresh capital.\textsuperscript{83} Finally, continued management of some NPLs by selling banks, coupled with the use of debt to purchase the NPLs, has raised questions as to whether these transfers would qualify as a true sale under IAS.\textsuperscript{84}

70. Successful resolution of NPLs also depends on strengthening the Bankruptcy Law and the legal framework for dealing with secured asset transactions, and establishing effective mechanisms to price and auction bad debts. Alternative approaches, such as bank recapitalization and further SOE reform, need to be pursued simultaneously, particularly because the VAMC cannot address uncollateralized debt. Progress in reducing NPLs—measured by stringent accounting standards—should be closely monitored and the operational arrangements of the VAMC should be further strengthened, if necessary.

71. In a positive development, the government replaced Decree 69 to enable increased foreign investment in domestic credit institutions.\textsuperscript{85} The amended Decree 01 took effect on 20 February 2014. It left the overall cap on foreign investment unchanged at 30\% (consistent with Viet Nam’s World Trade Organization commitments), but introduced several provisions that open the door for additional foreign investment.\textsuperscript{86} For instance, the decree’s application was broadened from banks to “credit institutions,” shareholding ceilings have been adjusted, and approval requirements were reduced (Table 3). Minimum capital requirements for Vietnamese credit institutions to sell shares to foreign investors were removed as well, and minimum capital requirements for nonstrategic foreign investors were lowered.

<table>
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<th>Table 3: Foreign Investor Shareholding Ceiling Adjustments</th>
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<td>Decree 01</td>
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<td>Any foreign individual</td>
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<td>Any foreign organization\textsuperscript{a}</td>
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<td>Any foreign investor and its related parties</td>
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<td>Any foreign strategic investor\textsuperscript{a}</td>
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<td>Total shareholding of foreign investors in a Vietnamese commercial bank\textsuperscript{a}</td>
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<td>Total shareholding of foreign investors in a Vietnamese non-bank\textsuperscript{a}</td>
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\textsuperscript{a} Exceptions may be given by the Prime Minister to weak credit institutions for restructuring on a case-by-case basis. Source: Mayer Brown and Freshfields Bruckhaus Deringer. 2014.
72. **Money market.** The government’s road map for money market development lays out concrete steps for the period up to 2020. In the short term, the government plans to strengthen the legal framework, provide an enabling environment, and introduce new money market instruments. For example, the SBV will improve circulars covering (i) lending mechanisms, (ii) interbank deposits, (iii) purchase and sale of valuable papers, (iv) the interbank foreign exchange market, (v) derivatives, (vi) open market operations, and (vii) information disclosure. In addition, the SBV will introduce credit and liquidity risk management standards for credit institutions. In close cooperation with market participants, a master repurchase agreement will be introduced and implemented starting with the interbank market. Steps will also be taken to develop a commercial paper and deposit certificate market. The SBV will begin transforming the Vietnam Banks Association into an SRO, coordinate with the MOF to issue standardized short-term financial instruments to develop the short end of the yield curve, and increase the transparency of its open market operations. Finally, the SBV will consider options to move toward a centralized electronic trading platform for interbank transactions, which would allow it to collect real-time market information. This initial phase of the road map is currently being implemented.87

73. In the longer term, the SBV and the MOF will also enhance coordination and focus on further developing financial markets, including the introduction of derivatives, and will expand the use of the master repurchase agreement to all market participants. The government also plans to improve the securities settlement process, strengthen operations of the VSD, and increase the transparency of money market activity. The functions of the Vietnam Banks Association, Vietnam Bond Market Association (VBMA), and Vietnam Securities Business Association will be strengthened, and these associations will likely assume responsibility for providing and enforcing a code of conduct, adopting uniform price quotation methods, and facilitating dispute resolution. The SBV will provide market participants with incentives to develop and improve risk management systems, management quality, and staff training.

74. **Bond markets.** A recently approved road map provides guidance to develop Viet Nam’s bond market through 2020 in close coordination with the development of other financial markets (Box 5).88 The government bond market represents one of the government’s primary initiatives. Under the road map, the primary government bond market is supported by predictable preannounced debt auctions and a coordination mechanism for debt issuance between the SBV and Treasury.89 The latter is intended to ensure a uniform development of the bond market and close coordination between fiscal and monetary policy. The government also plans to develop a primary dealer system and lay the foundations for market makers.90 Corporate bond market development will be supported as well by providing an enabling environment for issuance and for the establishment of credit rating agencies.

75. To stimulate demand, the government will implement policies for voluntary supplementary pension funds to make long-term investments in the bond market, and encourage bond purchases by the deposit insurance fund, social security fund, insurance companies, investment funds, private

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87 For example, in June 2012, the SBV issued Circular 21 on lending and borrowing operations and repo of valuable papers among credit institutions and foreign bank branches. Necessary amendments to this Circular were issued on 7 January 2013.


89 By identifying benchmark issues and lengthening maturities, the government has begun building a risk-free yield curve to establish reference rates. For example, the maturity of D70 trillion ($3.3 billion) in Treasury bond issuance planned for the first quarter of 2014 was 20% 1-year and less, 24% 2-year, 30% 3-year, 21% 5-year, 4% 10–15 year.

90 The VBMA introduced a Market Maker Agreement (MMA) in early 2012 with the following requirements for market makers in the secondary bond market: (i) ability to provide two-way quotations and provide letters of authorization to traders who engage in bond trading, (ii) volume of bonds held in hand: D600 billion, all tenors, and (iii) having the required infrastructure for bond trading. Market makers officially send quotations to the VBMA and follow the terms and conditions of the MMA. As of 5 September 2013, eight members participated.
investors, and foreign investors. Ancillary support will be phased in to adopt repurchase agreements and basic derivatives, and to allow the use of government bonds for reserve requirements of commercial banks. The government also plans significant improvements in financial infrastructure, including the modernization of information technology (IT) to provide more secure and efficient procurement, registration, custody, and listing of government(-guaranteed) bonds. As part of the plan, the cash leg of the settlement process for government bond transactions will be transferred from the BIDV to the SBV in the second quarter of 2014 to reduce settlement risk and times. Only member banks of the VSD are allowed to directly participate in the government bond settlement system, while members such as securities companies will make payments for government bond transactions through a settlement bank. The method of payment for government bonds will be changed from multilateral netting to real-time gross settlement. The VBMA will be tasked to enhance information disclosure, and to issue and maintain a set of market standards.

76. The government is improving its debt management and cash management as well. In its Medium-Term Debt Management Program, 2013–2015, the government for the first time set medium-term targets across its entire debt portfolio, including public and publicly guaranteed external debt, domestic debt, domestic and external debt guarantees broken down by recipient, and off-budget bond issuances. These targets are based on a preliminary analysis of costs and risks of the current and future proposed composition of the debt portfolio. The targets are consistent with the debt thresholds adopted in the Strategy of Public Debt and External Debt of the Country for the Period 2011–2020 and Vision up to 2030.

77. On cash management, the MOF is implementing Treasury Single Account (TSA) procedures in the BIDV and VietinBank. After the implementation of the TSA in these two SOCBs, the government intends to extend implementation to the remaining commercial banks by 2014. Once the TSA is fully implemented, cash balances will be consolidated and reduced from 700 to five Treasury Main Accounts. This will improve the quality of fiscal information, reduce the level of idle cash balances, reduce debt servicing costs, potentially increase returns on any surplus cash, and improve liquidity for timely payment processing.

78. **Equity market.** The government has issued a long-term strategy to develop the stock market, although its implementation plan clearly shows that other securities, such as bonds and derivatives,
are covered as well. Specifically, the government intends (i) to increase the depth and liquidity of the stock market by diversifying the investor base and increasing stock market capitalization to 70% of GDP by 2020; (ii) to improve the effectiveness of the equity markets by consolidating into a single stock exchange and modernizing the trading infrastructure; (iii) to raise the competitiveness of intermediaries; (iv) to reinforce the managerial, supervisory, and surveillance capabilities of the SSC; and (v) to strengthen international cooperation. Among others, planned reforms include an amendment of the Securities Law, applying international standards on information disclosure and corporate governance, linking primary and secondary bond markets, strengthening securities and fund management companies, improving the role of SROs, and strengthening clearing and settlement systems.

79. The strategy builds on a more comprehensive MOF and SSC road map to develop the Vietnamese stock market, which addresses major bottlenecks that impede capital market growth. This road map covers over 120 initiatives in a wide range of areas, including (i) perfecting the legal framework, (ii) enhancing reporting and information disclosure, (iii) diversifying the investor base, (iv) developing market intermediaries, (v) modernizing market infrastructure, (vi) strengthening international cooperation, and (vii) enhancing training and research.

80. Insurance. Viet Nam’s strategy to develop the insurance market in 2011–2020 aims at raising insurance premiums to 3%–4% of GDP, nearly quadrupling its investments in the economy, and attaining full compliance with International Association of Insurance Supervisors (IAIS) core principles by 2020. Its main pillars cover (i) improving the legal framework in line with international standards; (ii) raising the soundness, efficiency, and competitiveness of insurance companies; (iii) diversifying products; (iv) strengthening surveillance and supervision; (v) diversifying and professionalizing distribution channels; and (vi) promoting international integration and cooperation.

81. To achieve these objectives, the MOF adopted an action plan covering the period 2011–2015, which calls for legislative amendments to, among others, rationalize taxation and administrative procedures, and meet international commitments. Steps will also be taken to consolidate inefficient insurance companies, encourage investment portfolio diversification, reduce market fragmentation and.

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92 Decision No. 252/QD-TTg of 1 March 2013 of the Prime Minister approving the Strategy for Development of Viet Nam’s Securities Market in the Period 2011–2020. Ha Noi. The government has segregated its efforts into two distinct periods. For the period 2010–2015, the government will expand the scope of the Securities Law, gradually enhancing the role of SROs and upgrading the information disclosure and financial reporting of public companies. The government bond issuance process will be improved; public debt management will be enhanced; a standard yield curve will be built; the VSD will be modernized; and the capacity of the SSC to monitor the markets, investigate infractions, and correct violations will be strengthened. Initiatives planned for the period 2015–2017 include, among others, gradually building a primary dealer system, encouraging trading of interest rate derivatives on the stock exchange, enhancing disclosure, and introducing securities lending and securitization. Moreover, secondary trading would be increased through significant improvements in the market infrastructure. For instance, the VSD will be upgraded to a central clearinghouse and combined with the stock markets under a holding company with diversified ownership. Capital market research and training will be promoted as well. Pursuant to this long-term strategy, a plan was approved in March 2014 to develop a Vietnamese derivatives market on the stock exchange, starting with derivatives based on stock indices, government bonds, and listed shares.

93 Decision No. 1826/QD-TTg of 6 December 2012 of the Prime Minister approving the Scheme on Restructuring the Securities Market and Insurance Companies. Ha Noi. This decision classifies securities companies in four groups based on the capital ratio, with increasing levels of SSC supervision and intervention into operations. After a period under special control, operations of the fourth group may be suspended and securities companies dissolved.


95 Product diversification is aimed at satisfying the insurance needs of diverse organizations and individuals, including low-income entities.

between life and nonlife insurers, and encourage fair competition. Product diversification will be supported by streamlining approvals, reviewing and strengthening the existing compulsory auto and fire insurance regime, introducing professional liability insurance rules for insurance brokers, and piloting public insurance schemes for export credits or agriculture.

82. Further, the distribution network will be professionalized through regulation to establish standardized and specialized training for insurance agents, standards for training organizations, certification standards, and guidelines to better supervise the use of agents. In parallel, the government intends to strengthen its oversight by introducing more effective off-site supervision, establishing a surveillance and early-warning framework, enhancing on-site examination procedures, and more effectively addressing violations of law. The ISA also plans to standardize qualification standards and increase its staff to improve the depth and quality of supervision. Incentives will be provided to retain specialized staff, such as actuaries. Finally, the government plans to include insurance in bilateral and multilateral trade negotiations, and to actively participate, through the ISA, in the Association of Southeast Asian Nations (ASEAN) insurance regulator meetings and the IAIS. The ISA will review and evaluate its compliance with IAIS principles on management and supervision in order to fully comply with at least half of them by 2015.

83. **Accounting and audit.** The government has adopted a comprehensive plan to enhance the accounting and auditing regime in Viet Nam and to move closer to international standards. Specifically, the plan directs the MOF to establish a complete accounting and auditing system which is compatible with Viet Nam’s environment as well as regional and global standards. This will be supported by the development of a legislative framework for incorporating international best practice into Viet Nam’s specific conditions. Specifically, the government intends to submit an improved Accounting Law to the National Assembly for approval. Subsequently, the MOF will implement the revised Accounting Law and Independent Audit Law by updating and/or establishing new accounting and auditing standards in Viet Nam. Implementing regulations will also include guidance documents for independent audits, certification standards for audit firms and individual auditors, and supervision and investigation of audit firms and auditors. Moreover, administrative sanctions will be established for violations of the Accounting Law and Independent Audit Law.

84. The technical competence of all stakeholders—including the government—will be improved with measures to strengthen supervision of the accounting profession, develop necessary skills, enhance career management, develop more robust accounting and audit services, and strengthen cooperation with regional and international organizations. To boost the quality of accountants, the government plans to provide for a career development path and increase the number and strengthen the quality of enterprises offering accounting and independent audit services. For example, closer cooperation on audit careers will be sought with ASEAN and countries such as the United Kingdom and Australia. Surveillance and supervision of accounting and auditing activities will also be strengthened by, for instance, introducing greater financial disclosure and a self-management mechanism to support continuous education and ethical standards.

85. Finally, the organization and responsibilities of the Accounting and Auditing Policy Department will be reviewed, and training will be enhanced. By 2020, the self-regulatory function

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97 A December 2012 restructuring plan classifies insurance companies into four groups: (i) good liquidity and profit (allowed to expand operations), (ii) acceptable solvency ratios but operational inefficiencies (2-year business plan required and placed under evaluation), (iii) insufficient solvency ratios (restructure and transfer policies), and (iv) insolvent (special control with possibility of merger or bankruptcy).

98 Decision No. 480/QĐ-TTg of 18 March 2013 of the Prime Minister approving the Accounting-Audit Strategies up to 2020 with a vision to 2030. Ha Noi. While the government’s express intent is to approach international standards, a qualification has been added that the law will also be suitable for Viet Nam’s conditions, which may weaken its application. Further, the government will likely retain its practice of dictating accounting regimes for specific sectors.
of the Vietnam Association of Accountants and the Vietnam Association of Certified Public Accountants will be gradually developed to draft and update accounting and audit standards, hold exams, and so forth. Moreover, human resource management and IT systems will be strengthened, for example, in terms of training models, certification examinations, and supervision. While these measures are encouraging, the near-term adoption of IAS faces significant challenges due to the large overhang of impaired loans and assets. For example, the implementation of international standards covering the (de)recognition of financial assets, and fair-value accounting seems to contravene the accounting treatment currently used by the banking sector in disposing of NPLs to the VAMC.

86. **Microfinance.** Recognizing the potential of microfinance to reduce poverty, a Microfinance Development Strategy (2011–2020) was formulated with ADB assistance and approved by the Prime Minister. The strategy’s objective is to build a safe and sustainable microfinance system to serve the poor, low-income households, and small and medium-sized enterprises (SMEs). It demonstrates commitment to microfinance sector reform and aims at, among others, (i) establishing the necessary legal, regulatory, policy, and supervisory frameworks, (ii) strengthening regulatory and supervisory capacity, (iii) improving the operational capacity of MFIs, including the Vietnam Bank for Social Policies (VBSP), (iv) establishing financial infrastructure, and (v) raising general awareness of microfinance.

87. The microfinance strategy includes initiatives for a range of government agencies, including the SBV and the MOF, for the periods 2011–2015 and 2016–2020. The first phase of the SBV implementation plan includes formulating guidelines for the Credit Institutions Law related to microfinance. The SBV will also advise the government about solutions to manage the microfinance operations of political organizations, sociopolitical organizations, and nongovernment organizations. In addition, the SBV will assist MFIs to found a microfinance association, to establish microfinance training facilities, to train their staff and experts, and to develop a common microfinance database.

88. On 10 July 2012, the Prime Minister approved a development strategy for the VBSP covering the period 2011–2020. The objectives of the strategy are to increase VBSP’s stability and sustainability, transform it into a self-sustaining operation, and enhance its capacity to provide state policy credit to poor and near-poor households, and other policy-based beneficiaries (Box 6). As part of the implementation plan, the MOF will review and improve preferential credit policies for the poor and other policy beneficiaries. On 4 June 2013, the SBV granted a license to establish

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99. Incentives will be provided to encourage accounting and auditing agencies to retain experienced personnel with appropriate technical skills. A database will be built to track qualified accountants and auditors and ensure the proper consolidation of financial statements throughout the system.

100. Decision No. 2195/2011/QD-TTg of 6 December 2011 of the Prime Minister approving the Proposal of Designing and Development of a Microfinance System in Viet Nam up to 2020. Ha Noi.


103. Interest rate incentives will be different per target group and gradually reduced and replaced with other incentives. Near-poor households and other policy beneficiaries would access loans at interest rates approaching the market rate.
the Cooperative Bank of Vietnam, which will inherit the legal rights and obligations of the CCF and provide capital and other banking services to member PCFs. The reform was meant to turn the CCF into a strengthened apex institution for the PCF system with a greater mandate and authority in supporting its member PCFs.

89. The government also responded to the growing demand for insurance services suitable and accessible to the low-income sector by a two-step approach to set up a necessary regulatory framework. While the ISA is formulating this microinsurance regulatory framework for implementation in 2015, it has issued microinsurance pilot regulation that provides guidance to approved projects. This interim regulation meets the growing demand for microinsurance in a semiformal status, while ensuring its reliability until the formal regulatory framework for microinsurance becomes effective.

90. **Macroprudential.** The government has revised the decree defining the functions, tasks, powers, and organizational structure of the SBV, and is proposing a framework for macroprudential policy. The SBV created the Monetary and Financial Stability Department (MFSD) in February 2014. While the Banking Supervisory Agency will continue to be responsible for supervision of individual banks, the MFSD will be responsible for analyzing, assessing, and implementing macroprudential policy and introducing measures to prevent systemic risk in the financial system.

### B. ADB’s Sector Support Program and Experience

91. This section gives an overview of ADB’s support to financial sector development in Viet Nam, discusses the evaluation results of the Independent Evaluation Department and the Southeast Asia Department, and lists the main lessons learned.

1. **ADB Support**

92. ADB’s support program in Viet Nam was shaped primarily by four country strategy documents: the 1995 country operational strategy study, two country strategies and programs (2002–2004 and 2007–2010), and the CPS (2012–2015). Financial sector support has been
provided through several program loans, project loans, and TA. It has helped the government begin a transition from a centrally planned to a market-based economy with a broad financial sector, strong intermediaries, well-functioning markets, and a legal and regulatory infrastructure that promotes stability (Table 4).

Table 4: ADB Financial Sector Loans

<table>
<thead>
<tr>
<th>Loan</th>
<th>Title</th>
<th>Value ($ million)</th>
<th>Approval Date</th>
<th>Success Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>3081</td>
<td>Financial Sector Deepening Program (Subprogram 1)</td>
<td>45</td>
<td>6 Dec 2013</td>
<td>Unrated</td>
</tr>
<tr>
<td>3050</td>
<td>Second SME Development Program (Subprogram 2)*</td>
<td>50</td>
<td>23 Oct 2013</td>
<td>Unrated</td>
</tr>
<tr>
<td>2877</td>
<td>Microfinance Development Program (Subprogram 1)</td>
<td>40</td>
<td>5 Jul 2012</td>
<td>Unrated</td>
</tr>
<tr>
<td>2707</td>
<td>Third Financial Sector Program (Subprogram 2)</td>
<td>60</td>
<td>29 Nov 2010</td>
<td>Unrated</td>
</tr>
<tr>
<td>2680</td>
<td>Second SME Development Program (Subprogram 1)*</td>
<td>40</td>
<td>18 Oct 2010</td>
<td>Unrated</td>
</tr>
<tr>
<td>2377</td>
<td>Third Financial Sector Program (Subprogram 1)*</td>
<td>75</td>
<td>6 Dec 2007</td>
<td>Unrated</td>
</tr>
<tr>
<td>2284</td>
<td>SME Development Program (Subprogram 2)*</td>
<td>20</td>
<td>12 Dec 2006</td>
<td>Less than successful</td>
</tr>
<tr>
<td>2118</td>
<td>Financial Sector Development II (Subprogram 2)</td>
<td>35</td>
<td>3 Dec 2004</td>
<td>Successful</td>
</tr>
<tr>
<td>2095</td>
<td>SME Development Program (Subprogram 1)*</td>
<td>60</td>
<td>21 Oct 2004</td>
<td>Less than successful</td>
</tr>
<tr>
<td>1990</td>
<td>Housing Finance Project</td>
<td>30</td>
<td>20 Dec 2002</td>
<td>Successful</td>
</tr>
<tr>
<td>1932</td>
<td>Financial Sector Development II (Subprogram 1)</td>
<td>50</td>
<td>20 Nov 2002</td>
<td>Successful</td>
</tr>
<tr>
<td>1802</td>
<td>Rural Enterprise Finance Project</td>
<td>80</td>
<td>12 Dec 2000</td>
<td>Successful</td>
</tr>
<tr>
<td>1485</td>
<td>Financial Sector Program</td>
<td>90</td>
<td>19 Nov 1996</td>
<td>Successful</td>
</tr>
<tr>
<td>1457</td>
<td>Rural Credit Project</td>
<td>50</td>
<td>12 Sep 1996</td>
<td>Successful</td>
</tr>
</tbody>
</table>

SME = small and medium-sized enterprise.

* Included financial access component, but success rate pertains to entire program.

b Formerly Financial Sector Program Loan III.

Note: Success rates are based on project completion reports or independent validation reports, where available.

93. **Program loans.** ADB’s financial sector assistance began in 1993 with TA to help develop Viet Nam’s capacity to deliver rural financing with a focus on the Vietnam Bank for Agriculture and Rural Development. This was followed by three successive clusters of financial sector program loans (FSPLs) covering a wide range of reforms. The first FSPL supported the introduction and adoption of the basic concepts and systems that are prerequisites to developing a market-based financial system and economy. The program focused mainly on banking sector reforms, including enhancing the structure and operations of SOCBs, improving credit risk management, promoting deposit mobilization, and developing a legal framework for negotiable instruments and secured transactions.105 The program also recognized the importance of developing alternative funding channels through support for (i) a legal and regulatory framework for the securities market, (ii) a stock exchange, and (iii) an “organized” over-the-counter market for trading unlisted securities of private and privatized small and medium-sized corporations.

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Building on the accomplishments of its predecessor, the second FSPL aimed at developing a financial system with better intermediation, efficiency, and accessibility. The program helped develop the nonbanking sector, increase market-based financial intermediation, and provide long-term funding sources for economic development and poverty reduction. The program also introduced competition to the generally poorly performing banking sector. To achieve these objectives, the program supported reforms in (i) insurance, (ii) leasing, (iii) money markets, (iv) capital markets, and (v) financial sector infrastructure, with an emphasis on accounting and auditing, a secured transactions registry, deposit insurance, and an anti-money-laundering regime.

The third FSPL's objective was to create a deeper, more diversified, and resilient financial sector. By increasing the share of capital markets in financing investment, the program intended to contribute to sustained economic growth with reduced refunding risks. Greater scope and efficiency of nonbank financial intermediation channels were expected to strengthen financial sector stability through increased competition. The program focused on delivering four main outputs. First, it aimed to increase market liquidity and lower transaction costs by enhancing information dissemination and improving the infrastructure for secondary trading of securities. Second, the institutional framework for securities issuance was reinforced through, among others, the establishment of a public debt management office. Third, the legal and regulatory framework for investor and consumer protection and financial stability was enhanced by, for example, introducing penalties for administrative offences under the new Securities Law, requiring public disclosure of securities market regulation violations, and promulgating new solvency ratios for credit institutions. The program also reinforced ADB's previous support to the anti-money-laundering regime by supporting the operationalization of the country's Anti-Money-Laundering Information Center. Finally, regional cooperation was intensified, for instance, by signing bilateral information exchange agreements on securities market issues.

Financial inclusion. ADB's first financial intermediation loans sought to increase access to credit for small farmers and rural enterprises and to provide low-income families access to housing finance. Specifically, the Housing Finance Project supported lending to low-income households through participating commercial banks, and housing microfinance to urban poor households through community-based financial institutions. The project also helped establish a housing finance facility in the SBV. SMEs have benefited from program loans as well. The two SME Development Cluster Programs included support to develop an enabling policy and regulatory environment, to provide access to land and international markets, and to enhance competition policy. The cluster programs have included a number of reforms aimed at facilitating access to finance for SMEs. While FSPLs have concentrated on addressing the systemic flaws of financial markets, the SME Development

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94. ADB. 2002. Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Socialist Republic of Viet Nam for the Financial Sector Program Loan II. Manila; and ADB. 2004. Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Socialist Republic of Viet Nam for the Second Financial Sector Program–Subprogram II. Manila. The program was also expected to have an impact on (i) the operational restructuring of SOCBs by reinforcing their commercial orientation through improved liquidity management and participation in the money market, (ii) the restructuring of SOEs by instituting a mechanism for privatization through initial public offering, and (iii) access of SMEs to term financing through leasing and the SME trading board.

95. ADB. 2007. Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Socialist Republic of Viet Nam for the Financial Sector Program Loan III. Manila; and ADB. 2010. Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Socialist Republic of Viet Nam for the Second Financial Sector Program–Subprogram III. Manila. Subprogram 2 was refined to reflect the impact and lessons from the global financial crisis and the need to emphasize financial stability.

96. The first SME Development Program included reforms for (i) improving the quality of financial reports by simplifying SME accounting standards, (ii) making it easier to use land use rights certificates as collateral for loans, (iii) improving the legal framework for leasing to promote sales of lease receivables, and (iv) making lending secure by making movable assets more attractive to banks. The second SME Development Program included a credit guarantee scheme for SMEs and pilot operations of the unlisted public companies market.
Program focused on alternative financing options for the domestic private sector, such as leasing, access to the stock market, or the implementation of credit guarantee schemes. It also included measures aimed at facilitating SME access to loans by developing the capacities of personnel from SOCBs with regard to the SME sector. In addition, the second FSPL aimed at improving access to term financing for SMEs through leasing and the SME trading board.

97. **Technical assistance.** ADB has provided TA to, among others, help the government prepare for loans and provide input into formal government sector development strategies. TA has also been used to build the organizational and technical capacity of regulatory and supervisory institutions, and to support regulatory reform by assessing domestic regulatory frameworks in relation to international standards. Recent TA support ranges from legal advice on introducing repurchase agreements in Viet Nam’s capital markets to building the institutional capacity of a microinsurance entity for women on a pilot basis to facilitate the formalization process. A recent regional initiative between ADB and the ASEAN Capital Markets Forum resulted in the publication of the ASEAN Corporate Governance Scorecard, which assesses corporate governance standards of publicly listed companies based on a comparison with international good practices. The initiative also produced country-specific recommendations for publicly listed companies and capital market regulators to improve their corporate governance standards, and provided a summary assessment for publicly listed companies.

2. **Evaluation Results**

98. **Programs.** The first two FSPLs have been rated and independently validated as successful, with supported reforms contributing to concrete and likely sustainable results. A program completion report (PCR) for the third FSPL is expected to be issued in 2014. The recently completed PCR of the Housing Finance Project rated this project successful as well. Despite initial implementation delays, a revision of the loan agreement, and resulting extension of the implementation period, the project gained momentum and eventually achieved 95% of its disbursement plan and complied with almost all loan covenants.

99. **Country assistance program.** The most recent country assistance program evaluation (CAPE) for Viet Nam assessed the performance of ADB’s country strategies and assistance programs...
covering the period 1999–2008. Based on successful institutional and partly successful project ratings, overall financial sector assistance was rated borderline successful. This qualification arose primarily from the poor performance of housing finance assistance, at the time of evaluation, and the comparatively slow progress made in some reform areas. More specifically, the CAPE concluded that ADB’s choices of assistance, approaches, and modalities in the financial sector were generally relevant. ADB’s program was well sequenced by first undertaking basic framework assistance and then expanding to more complex reforms.

100. ADB assistance was also deemed largely effective and efficient, although the achievement of meaningful outcomes in some reform areas of the second FSPL was expected to take longer and require additional reforms. These ratings were affected by the substantial implementation delays and slow disbursement of the Housing Finance Project.

101. ADB assistance was likely to be sustainable given the government’s political commitment to continued reform and an absence of any major policy reversals, albeit on the low side due to underlying capacity issues and the lack of institutional impact in some areas. In light of the government’s cautious approach to financial market development, the impact of assistance was considered to be modest. This approach is reflected by the continuing dominance of the state-owned bank sector and relatively high levels of government intervention to address economic problems (e.g., interest rate subsidies). The CAPE noted that the impact of the financial sector intermediation loans had been small as, at the time of review, they had not led to any substantial changes in existing funding strategies or lending practices. Finally, the CAPE concluded that the level of TA resources attached to policy loans was on the low side, given the financial sector’s substantial capacity development needs and the nature of Viet Nam’s reform agenda.

102. Capital market development. A special evaluation study on ADB assistance for domestic capital market development covered the period 1987–2006. The study derived useful sector-specific lessons and rated ADB’s assistance in Viet Nam as successful, which was somewhat better than ABD’s overall performance in the six countries that were investigated. Strategically, ADB’s capital market assistance in the country was regarded as highly selective and well sequenced, while benefiting from substantial aid coordination.

103. Of the six countries investigated, political commitment to and government ownership of capital market reforms over a longer period appeared to have been strongest in Viet Nam and the Philippines, which contributed to the sustainability of reforms. However, a lack of technical understanding on the part of political decision makers affected the formulation or implementation of the earlier sector programs in Viet Nam, as ADB did not provide resources to familiarize key government officials and parliamentarians with sector issues. While progress was made in strengthening its regulatory framework, the special evaluation study noted that Viet Nam was likely

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114 For instance, the effectiveness of deposit insurance was impacted by the absence of special bank insolvency legislation and its weak legal basis (decree rather than law); the established secured transactions regime was suffering from legal inconsistencies, lack of enforcement, and inadequate registration processes; and continued capacity problems constrained reform efforts in financial reporting, insurance, and leasing. Moreover, the government was seen to occasionally diverge from TA recommendations that were in line with best practices, as they were perceived to not adequately reflect Viet Nam’s specific conditions and circumstances. While such assistance undoubtedly contributed to internal debate on key issues, immediate outcomes did not always match expectations. It is noteworthy that some of these laws and regulations were subsequently strengthened in light of experience gained during actual implementation.

116 This rating was based on the following underlying performance assessments. The program was rated relevant, effective, less efficient, and likely sustainable. The institutional rating was considered successful, based on substantially strategic positioning, a modest impact, and successful ADB performance.
to require more time, additional capacity development support, and/or political commitment to regulatory independence to be able to move toward full compliance with international standards.

3. Lessons Learned and Best Practices

104. The CAPE recommended a continuation of financial and technical support for financial sector reforms, while providing adequate resources to capacity development efforts. More specifically, it noted that ADB-supported regional capital market development should increasingly include Viet Nam and that standard due diligence requirements should be applied to assess the effective demand, financial condition, and governance of participating financial intermediaries in financial intermediation loans.

105. Based on the CAPE, PCRs, program validation reports, and recent programs, several general lessons for future assistance can be drawn from ADB’s experiences in the Vietnamese financial sector:

106. **Emphasize tangible results.** Program loans need to increasingly emphasize the delivery of actual results rather than ascertaining if policy actions are met. The details of implemented reforms can be crucially important in making the difference between achieving stated objectives or exactly the opposite. This implies that immediate and longer-term results of implemented reforms should always be closely monitored. Rather than having a check-the-box mentality for reforms, all relevant stakeholders, including ADB, the executing agency, implementation agencies, and market participants, should remain in close communication on the program’s detailed contents prior to and during implementation.

107. **Address preconditions for reform.** In transition economies such as Viet Nam, many interrelated elements of institutional infrastructure for a market economy still need to be built from the ground up. Hence, development partners need to ensure that institutional preconditions are in place to achieve the intended impact of reforms and avoid unanticipated risks.

108. **Provide adequate time and ensure coordination.** Fundamental reforms require a medium- to long-term approach, considerable awareness building and capacity development, and often a high degree of inter-institutional coordination. Strong support from the government and development partners over that period is essential to allow new institutions and legal frameworks to establish themselves, strengthen, and reach the point where they are able to function effectively on a sustainable basis.

109. **Ensure proper sequencing.** A clearly defined step-by-step approach to complex reforms is essential, particularly where new institutions, legal and regulatory frameworks, or standards are being introduced. Such a focused and phased approach may better accommodate capacity constraints, avoid delays, and enable measurement of outcome and impact more accurately.

110. **Build in flexibility.** As the legal, policy, and institutional framework in Viet Nam is constantly evolving, development partners should be able to adjust the design and implementation of policy-based loans, projects, and technical assistance to changing economic circumstances, the impact of initial policy actions, and the results of capacity-building efforts. From this perspective, the program loan cluster has been a useful instrument.

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117 ADB also considers the more general lessons and recommendations of the Special Evaluation Study in processing loans and technical assistance.

118 For instance, money market activity initially declined after Circular 21 became effective in 2012. It started picking up again after necessary amendments were implemented in early 2013.
111. **Ensure stakeholder ownership of reforms.** Development partners are more likely to influence reforms where there is strong government ownership of the development agenda. Reforms will not necessarily take place unless all concerned groups and decision makers are convinced of their benefits and political viability. In particular, early consultation with decision makers can help build consensus in formulating legislation.

112. **Anticipate lengthy approval processes.** Program design has not always taken into consideration complex and lengthy government procedures and the weak implementation capacity of some executing or implementing agencies, or even the overall risk aversion by some staff responsible for implementation. This oversight has led to insufficient efforts to build implementation capacity during program design, preparation, and implementation.

113. **Choose effective program modalities.** Program loans, coupled with strategic technical assistance and capacity development, have served as an effective instrument and are laying the foundations of the policy and regulatory framework for reforms. Development partners can help change occur—but not force its pace—by supporting pilots, analysis, and knowledge sharing to contribute to discussions on policy alternatives.

114. **Provide sufficient TA support.** Sufficient TA allocation is particularly important for program loans in countries with limited institutional capacity. This is deemed most effective when it is focused, benefits from adequate government ownership, and provides not only for the preparation of studies or legal drafting but also for the operationalization of program outputs and sustained capacity building.

115. **Coordinate closely with donors.** Given the substantial donor support for the financial sector, ADB strategies and programs need to be closely coordinated with those of other development partners.

116. **Integrate reform efforts.** In the area of inclusive finance, past experience highlights the importance of integrating microfinance regulation in general banking law and harmonizing it with microfinance-specific regulations to promote fair competition among diverse financial institutions. Such experience also demonstrates the need for the government to focus on creating an enabling environment to support private sector development in microfinance rather than being directly involved in microfinance operations.

### C. Coordination with Other Development Partners

117. Implementation of the government’s financial sector reform program continues with strong development partner support, as evidenced by the number of projects and the amount of funds provided. While there is a reasonable degree of coordination among donors contributing to financial sector development, continued efforts remain essential to minimize the overlap of activities and to better align donor support. Moreover, enhanced donor coordination could play a role in addressing the weak coordination and planning described in para. 42. This section describes activities of the main multilateral and bilateral donors. A detailed overview of ongoing projects and programs is listed in Appendix 3.

118. **Joint Development Partner Program Loan Operations.** ADB has supported various joint development partner program loan operations that included financial sector policy actions. This support has been extended through parallel loan financing as well as TA support.¹¹⁹ Specific policy actions covered a range of issues, including (i) the revised SBV Law focusing on its mandate and

¹¹⁹ ADB extended about $200 million through the poverty reduction support credit series during 2004–2011.
on enhancing its autonomy in regard to monetary policy and financial sector stability; (ii) regulation to enhance public disclosure and communication of SBV policies and banking sector statistics; and (iii) regulations to better assess commercial banks’ portfolio risks, enhance public disclosure, and strengthen supervision.

119. **International Monetary Fund.** The IMF is providing continued guidance to the SBV on monetary policy instruments and operations, and assistance in developing monetary and balance of payments statistics, reporting systems, and financial soundness indicators. The IMF also provides regular training to government officials engaging in macroeconomic policy formulation and coordination. In June 2013, an Article IV consultation was concluded that identified the financial and SOE sectors as key sources of vulnerability and gave useful recommendations. Since 2011, ADB has been participating as an observer in selected Article IV mission consultation meetings. The IMF consults with ADB during preparation of the joint ADB–World Bank public debt sustainability analysis.

120. **World Bank.** The World Bank provides *Financial Sector Soundness and Institutional Capacity Building* for regulatory and policy making bodies to, among others, better assess and address financial sector problems, and help bring the regulatory and supervisory framework closer to international best practices. Through the *Financial Sector Modernization and Information Management System* project, the World Bank assists the SBV, the Credit Information Center, and the Deposit Insurance of Vietnam in improving the delivery of their primary responsibilities. Specifically, the project is developing a centralized integrated system of advanced business processes and a modern IT architecture, and is strengthening institutional capacity. The World Bank also provides assistance to strengthen the government’s capacity to address market failures, and is improving access to finance through the *Access to Financial Services/Financial Inclusion* project. Finally, the World Bank’s third *Rural Finance* project will support enterprises and households in rural areas, and will help participating banks build capacity in credit appraisal skills, social protection, and corporate governance. ADB and the World Bank jointly conducted some debt sustainability analysis capacity-building training during 2013.

121. **International Finance Corporation.** The International Finance Corporation (IFC) focuses on capital market development, including the establishment and operations of the VBMA, by strengthening market standards through a code of conduct, market conventions, back office manuals, and primary bond market training and seminars. The IFC is implementing a microfinance program cofinanced by the Swiss State Secretariat for Economic Affairs (SECO) to assist the government in developing a policy and regulatory framework and supporting promising microfinance institutions. The IFC is also providing advice to help expand access to finance for SMEs through the *Viet Nam Bank Advisory* project and, with cofinancing from SECO, a project on a *Secured Transaction Legal Framework*.

122. **Bilateral donors.** Financial sector development is supported by various bilateral donors as well, including the Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), the Canadian International Development Agency, the Japan International Cooperation Agency (JICA), SECO, and the Agence Française de Développement. For instance, GIZ has a long history of assisting the SBV with the formulation and implementation of monetary and exchange rate policies. GIZ is currently supporting *Capital Market Development* by providing advice on bond swaps, new bond product development, derivatives, central counterparty settlement, and cash settlement for securities transactions through the SBV. GIZ also helps to build risk management capacity for banks.

123. **JICA supports the SBV through the following projects:** (i) *Mutual Cooperation for Human Resource Development of the SBV*; and (ii) *Strengthening Functions of the SBV*, which focuses on issuance and vault operations. JICA also initiated the *Viet Nam Bank Restructuring Support Project*. In addition to supporting microfinance, secured transactions, and anti-money laundering with

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120 International Monetary Fund. [http://www.imf.org/external/np/sec/pr/2013/pr13304.htm](http://www.imf.org/external/np/sec/pr/2013/pr13304.htm)
other donors, SECO is actively assisting the SBV through Banking Sector Strategy Development and Monitoring and Capacity Building. SECO also supports capacity building and regulatory development for anti-money laundering and combating financing of terrorists.

124. The Agence Française de Développement is actively supporting financial inclusion and access to finance by developing PCF networks in poor regions, strengthening the CCF–PCF network, and providing institutional support to PCFs, including risk management. Recently, an important initiative was launched by the Canadian International Development Agency to strengthen the institutional and technical capacity of SBV’s Banking Supervisory Agency. Its Banking Regulation and Supervision Support project will help implement risk-based supervision, including regulation, licensing, and related organizational development.

D. ADB Sector Forward Strategy

125. **Strategy 2020.** Under its long-term strategy, ADB is transforming itself to meet regional challenges, while remaining dedicated to reducing poverty—its overarching goal since 1999. ADB is pursuing its vision and mission by focusing on three complementary strategic agendas: inclusive growth, environmentally sustainable growth, and regional integration. To better mobilize resources and to maximize returns on its unique regional experience within the evolving aid architecture, ADB is focusing on five drivers of change: (i) private sector development and private sector operations, (ii) good governance and capacity development, (iii) gender equity, (iv) knowledge solutions, and (v) partnerships.

126. ADB also refocused its operations into five core specializations that best support its agenda, reflecting developing member countries’ needs, ADB’s comparative strengths, and the complementary efforts of development partners. These core specializations are (i) infrastructure, (ii) environment including climate change, (iii) regional cooperation and integration, (iv) financial sector development, and (v) education. In other areas, ADB will continue operations only selectively in close partnership with other agencies.\(^\text{121}\)

127. **Intersection of Strategy 2020 and the Socio-Economic Development Plan.** Strategy 2020 and Viet Nam’s SEDP have as common goals inclusive economic growth, environmentally sustainable growth, and regional cooperation and integration.\(^\text{122}\) ADB’s programs in regional cooperation and integration will contribute to strengthening Viet Nam’s resilience regarding external shocks and cross-boundary challenges through the provision of regional public goods and the benefits derived from better connectivity. SEDP’s focus areas of economic restructuring, human resource development, and infrastructure improvement are shared with Strategy 2020. Financial sector development, good governance and capacity development, and private sector development, which SEDP considers important to enhancing Viet Nam’s economic efficiency and productivity, are highlighted in Strategy 2020 as well. Partnerships and knowledge solutions remain important in ADB’s operations.

128. **Country partnership strategy.** Based on its CPS, 2012–2015, ADB will support Viet Nam’s goal to rise to upper middle-income country status through three pillars: inclusive growth,

\(^{121}\) As the midpoint of Strategy 2020 approaches, ADB considers it important to take stock of its progress and determine whether the institution is on track to achieving the abovementioned goals and objectives. ADB therefore completed a midterm review of strategy 2020 in 2014. For more information: http://www.adb.org/strategy-2020-mid-term-review

enhancing economic efficiency, and environmental sustainability. Thematic considerations such as good governance and capacity building, private sector development, climate change, regional cooperation and integration, and gender equity will be actively pursued. ADB will maximize the development impact of its operations in Viet Nam by selectively focusing on those Strategy 2020 sectors in which ADB can add the most value in the form of financing and knowledge transfer. ADB will prioritize the financial and five other sectors, including (i) agriculture and natural resources, (ii) education, (iii) energy, (iv) transport, and (v) water supply and other municipal infrastructure and services. Support to improving public sector management will be crosscutting and strengthen sector operations.

129. **Financial sector support.** To enhance economic efficiency, ADB will continue supporting the government’s long-term task of deepening the financial sector, which will help mobilize greater resources and allocate them more efficiently. Specifically, assistance aims to strengthen legal, regulatory, and institutional frameworks and market infrastructure to sustain the financing of investments using domestic and foreign sources. Moreover, there will be a focus on institutional capacity building through strengthened public sector management, including public administration reform and macroeconomic management. ADB’s assistance will also help integrate the poor and other vulnerable groups and segments of society in the development process through better access to opportunities arising from microfinance. At the same time, ADB’s private sector operations will support financial sector development and broad economic growth through a range of activities, including the Trade Finance Program; possible equity investments in banks, other financial institutions, and private equity funds; credit lines to finance sector entities to support microfinance, insurance, SMEs, and housing; and leasing. In addition, ADB can strengthen capacity development in the financial sector through targeted TA combined with financing.

130. **Ongoing and planned support.** The CPS is operationalized in ADB’s country operations business plan, 2013–2015, which includes indicative allocations of $1,127 million from the Asian Development Fund and $2,646 million from ordinary capital resources. Support to financial sector development—as a percentage of the total CPS envelope—is expected to increase to 4.7%. The sector road map and results framework provides an overview of ongoing and planned interventions for the period 2012–2015, along with targeted sector outputs and outcomes (Appendix 1). In the area of support for SME access to finance, ADB aims to evolve its initiatives from comprehensive reform packages articulated around policy matrices to more targeted and, possibly, project-based initiatives. The pipeline includes a Microfinance Development Program loan, Financial Sector Deepening Program loan, Improving Competitiveness Program loan, and Enhancing Financial Stability TA.

131. **Microfinance Development Program.** The Microfinance Development Program loan, which was approved on 5 July 2012, supports the development of market-oriented microfinance to increase access to formal financial services for the poor, especially in rural areas. The program was formulated to promote fair competition among diverse financial institutions and to support the private sector’s role in microfinance, thereby gradually reducing the government’s direct involvement in microfinance operations. Under Subprogram 2 (2012–2014), regulations and supervisory

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123 The strategy presented is for discussion purposes only, and represents no commitment on behalf of ADB or its clients.
126 The ongoing accompanying TA helps implement the program, in order to achieve success in key policy actions: (i) formulation of draft implementing rules and regulations on microfinance, (ii) study of and recommendation on fiscal and regulatory incentives for microfinance operations, (iii) support to the development of a microfinance credit information exchange system, and (iv) support to the development of microinsurance regulations. The Capacity Development TA of $1 million approved in June 2013 aims to strengthen microfinance sector operation and supervision through training for concerned financial institutions and supervisory agencies.
norms for microfinance will be formulated. Microfinance supervisory capacity will be enhanced in accordance with the promulgated regulations. The VBSP will implement its development strategy, which was formulated under Subprogram 1, to become a sustaining financial institution operating on market-based principles. The Cooperative Bank will be transferred from the CCF and will strengthen its institutional and operational capacities for the member PCFs. The program seeks to develop financial infrastructure through formal microfinance training, advocacy of financial literacy on sustainable microfinance and customer protection, and credit information exchange systems. Subprogram 2 plans to propose, according to the approved programmatic approach, its loan for Board consideration in 2014.

132. **Financial Sector Deepening Program.** The Financial Sector Deepening Program loan was approved on 6 December 2013 and aims at increasing the role of the nonbank financial sector. The program will support developing a well-functioning money market and a deeper and more liquid capital market, with a focus on government debt, as the basic building blocks of financial sector development and effective macroeconomic management. For example, the money market is expected to benefit from swift execution of the money market development master plan, a strengthened legal and operational framework, and better coordination between the MOF and the SBV. Bond market liquidity will be increased by, among others, improved public debt management, enhanced predictability and operation of the public debt issuance process, a bond market development road map, and a tightened information disclosure regime. This will help build a risk-free yield curve. Ancillary support includes reduced operational risk in the securities settlement process, an insurance market development road map, and strengthened enforcement capacity of the SSC. Finally, the Financial Sector Deepening Program will help strengthen the capacity of public and private institutions with a focus on human resource development in the SBV and the SSC, in-house debt sustainability capacity in the MOF, accounting and auditing standards, and an improved legal framework for the insurance sector.

133. **Improving Competitiveness Program.** The Improving Competitiveness Program, which is expected to be submitted for Board approval in 2014, is a policy-based loan that supports the Economic Management Competitive Credit (EMCC). This joint development partner budget support program is aligned with the national reform priorities of Viet Nam and aims at enhancing competitiveness to boost economic growth and reduce poverty. The EMCC consists of a programmatic series of three policy-based operations to be implemented during 2013–2015. The first EMCC has already been approved. The Improving Competitiveness Program will support policy actions under the second EMCC relating to financial sector reform. Policy actions include (i) an amendment of Decree 69 to enable increased foreign investment in domestic commercial banks, (ii) the adoption of a comprehensive policy framework to address the problem of NPLs across the banking sector, (iii) the approval of a Medium-Term Debt Management Program, 2013–2015 based on an analysis of cost and risk of the total debt portfolio of the general government, and (iv) the implementation of TSA procedures in two commercial banks. These policy actions reinforce and complement ADB’s ongoing policy reform programs to deepen the financial sector.

134. **Enhancing Financial Stability TA.** ADB is providing a small-scale policy and advisory TA project to scope options designed for establishing a macroprudential framework and building capacity of the MFSD. The impact of the Enhancing Financial Stability TA will be stronger interagency and intra-agency coordination on financial stability. The expected outcome of the TA is a clear road map for the SBV on developing a well-functioning institutional framework for

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macroprudential policy and capacity development needs. Stronger interagency and intra-agency coordination will help the SBV to monitor financial soundness and strengthen safeguards against financial instability, which will, in turn, support restructuring efforts and help to develop the banking sector as a solid foundation for macroeconomic and financial developments. Its key outputs include a set of reports and recommendations to scope (i) various framework options for macroprudential policy and mechanisms for intra-agency and interagency coordination and information exchange, (ii) various design options for macroprudential policy and its instruments that best suit Viet Nam's circumstances and current stage of financial sector development, and (iii) a medium-term capacity building and training program for the proposed MFSD.\footnote{Development partners may consider following up with a larger-scale capacity development TA to institutionalize and implement policy recommendations generated from this small-scale TA.}
Appendix 1
Sector Road Map and Results Framework (2012–2015)

<table>
<thead>
<tr>
<th>Viet Nam Sector Outcomes</th>
<th>Viet Nam Sector Outputs</th>
<th>ADB Sector Operations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Outcomes with ADB Contribution</td>
<td>Indicators with Targets and Baselines</td>
<td>Outputs with ADB Contribution</td>
</tr>
<tr>
<td>Nonbank finance markets provide an increased share of financing to support domestic investment.</td>
<td>Share of nonbank finance sector assets to total financial sector assets increasing from 15% in 2010 to 25%–30% in 2015. Increase in the size of the local currency debt market to 20% of GDP in 2015 from 15% in 2010. Increase in combined stock market capitalization to 45% of GDP in 2015 from 38% in 2010.</td>
<td>Alternative channels of market-based nonbank financial intermediation developed.</td>
</tr>
<tr>
<td>(ii) Pipeline projects</td>
<td>Financial Sector Deepening Program loan: 2013, $45 million; 2014, $70 million (indicative). Microfinance Development Program loan: Subprogram 1 of ADF $40 million; Subprogram 2 of ADF $50 million (indicative). Improving Competitiveness Program (2014, $77 million). Supporting Microfinance Development Program (ADB PATA of $0.5 million).</td>
<td>Microfinance Development Strategy and road map approved, increased number of licensed microfinance institutions and cooperative banks, reporting microfinance client data disaggregated by sex in place. Strengthened supervisory and regulatory capacity in the microfinance regulators.</td>
</tr>
</tbody>
</table>

continued on next page
### Viet Nam Sector Outcomes

<table>
<thead>
<tr>
<th>Outcomes with ADB Contribution</th>
<th>Indicators with Targets and Baselines</th>
<th>Outputs with ADB Contribution</th>
<th>Indicators with Incremental Targets</th>
<th>Planned and Ongoing ADB Interventions</th>
<th>Main Outputs Expected from ADB Interventions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increased access for poor and low-income households to sustainable and affordable microfinance services.</td>
<td>Number of microfinance borrowers increasing by 10% in 2014, (2010 baseline: 12.5 million).</td>
<td>Microfinance services expanded.</td>
<td>Increase in the number of microfinance institutions from 2 in 2012 to 5 in 2014.</td>
<td>Strengthening Microfinance Operation and Regulation (ADB CDTA, $1 million).</td>
<td>Strengthened microfinance credit institutions and improved infrastructure and training.</td>
</tr>
<tr>
<td></td>
<td>Number of savings accounts increasing by 10% in 2014 (2010 baseline: 9.7 million).</td>
<td></td>
<td>Increase in the number of trained regulators by 30% from 2012 to 2014.</td>
<td>Preparing Microfinance Development Program Subprogram 2 (ADB PPTA, $0.6 million).</td>
<td></td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>Improvement of operational self-sufficiency in the VBSP to 90% in 2014 from 77% in 2010.</td>
<td>(iii) Ongoing projects</td>
<td>(iii) Ongoing projects</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>A microfinance center established by 2014.</td>
<td>FSDP (PPTA, $0.6 million).</td>
<td>Formalized microfinance institutions.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Preparing Microfinance Sector Development Program (ADB PPTA, $0.5 million).</td>
<td>Enabled environment, strengthened supervision, and improved standards.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Formalizing Microfinance Institutions (ADB JFPR, $1.5 million).</td>
<td>Money market established, a more liquid bond market, and capacity developed.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>TFSP (PPTA, $1 million).</td>
<td>Options for macro-prudential policy, instruments, and coordination mechanisms.</td>
</tr>
<tr>
<td>Improved competitiveness of the economy.</td>
<td>Ranking in the World Economic Forum Global Competitiveness Report improved with 15 places by 2018 from 75th in 2012.</td>
<td>Financial stability enhanced.</td>
<td>Proportion of outstanding loans defined as nonperforming reduced from 8.6% in 2012 to 5% or less by 2015, based on Viet Nam Accounting Standards.</td>
<td>Enhancing Financial Stability (ADB S-PATA, $0.225 million).</td>
<td></td>
</tr>
</tbody>
</table>


* Indicator and target reflect the preliminary broader outcome targeted by the Improving Competitiveness Program in support of the Economic Management Competitive Credit.

* While the full amount of the loan is $230 million, the $77 million reflects a prorated amount supporting the financial and fiscal sector.

Appendix 2
Financial Sector
Problem Analysis

Core problem
Nonbank financing of economic activities is limited

Limited and inefficient investment constrains modernization, economic development, and integration

Underdeveloped nonbank financial sector impedes business development

Reliance on short-term financing and weak supervisory regime reduces investor confidence

Limited capacity hurts regional and international competitiveness

Common inhibiting factors on supply side
- Lack of a complete and reliable yield curve (covering short and long ends of the markets)
- Slow adoption of a full-fledged market-based and indirect monetary policy framework by the State Bank of Viet Nam
- Lack of holistic planning for capital market development and inadequate coordination and planning across agencies, market regulators, and supervisors
- Lack of coordination and sufficient capacity in State Bank of Vietnam and the Ministry of Finance to develop money market and related infrastructure
- Limited cohesion of financial market infrastructure

Common inhibiting factors on demand side
- Absence of timely, accurate, and publicly available market information
- Market volatility leading to reduced retail participation and demand

Inhibiting factors on supply side
- Legal, policy, regulatory, and supervisory frameworks for microfinance operating credit institutions still under formulation
- Weak operational capacity of microfinance operating credit institutions
- Weak regulatory and supervisory capacity
- Underdeveloped infrastructure for microfinance including the absence of microfinance credit information exchange systems

Inhibiting factors on demand side
- Nationwide financial literacy program yet to be formulated

Equity market
Segmented and of limited size

Securities market
Illiquid, shallow, and fragmented
- Money market
- Bond market

Contractual savings and nonbank finance
Underdeveloped
- Insurance
- Pension
- Leasing

Bank intermediation
Constrained
- Undercapitalization
- Low profitability
- Nonperforming loans
- Limited operational scale

Microfinance market
Government-dominated, uncompetitive, inefficient, offering inadequate products and services

Credit market
Sectoral and regional market

Inhibiting factors on supply side
- Lack of a complete and reliable yield curve (covering short and long ends of the markets)
- Slow adoption of a full-fledged market-based and indirect monetary policy framework by the State Bank of Viet Nam
- Lack of holistic planning for capital market development and inadequate coordination and planning across agencies, market regulators, and supervisors
- Lack of coordination and sufficient capacity in State Bank of Vietnam and the Ministry of Finance to develop money market and related infrastructure
- Limited cohesion of financial market infrastructure

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- Weak regulatory and supervisory capacity
- Underdeveloped infrastructure for microfinance including the absence of microfinance credit information exchange systems

Inhibiting factors on demand side
- Nationwide financial literacy program yet to be formulated
# Appendix 3
## Major Financial Sector Programs of Development Partners

<table>
<thead>
<tr>
<th>Development Partner</th>
<th>Project Name</th>
<th>Duration</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>General</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>IMF</td>
<td>Financial Sector Assessment Program Economic Management and</td>
<td>2012–2013</td>
<td></td>
</tr>
<tr>
<td>World Bank</td>
<td>Financial Sector Soundness and Institutional Capacity Building (TA)</td>
<td>2011–2015</td>
<td>$2 million</td>
</tr>
<tr>
<td>JICA</td>
<td>Viet Nam Bank Restructuring Support Project (TA)</td>
<td>2013–2015</td>
<td></td>
</tr>
<tr>
<td>SECO</td>
<td>Banking Sector Strategy Development and Monitoring &amp; Capacity Building</td>
<td>2010–2015</td>
<td>SwF1.3 million</td>
</tr>
<tr>
<td>World Bank, JICA, ADB, DFID, SECO, AusAID</td>
<td>Competitiveness Credit (macroeconomic stability pillar supports financial sector stability and improved fiscal discipline)</td>
<td>2013–2015</td>
<td></td>
</tr>
<tr>
<td><strong>Banking</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>IFC</td>
<td>Viet Nam’s Bank Advisory Project (TA) – Providing advisory services to help expand access to finance for SMEs</td>
<td>2007–2013</td>
<td>$1 million</td>
</tr>
<tr>
<td><strong>Capital Market</strong></td>
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</tr>
<tr>
<td>IFC</td>
<td>Capital market development (including assistance to VBMA in building capacity and support for market development)</td>
<td>2008–2013</td>
<td>$1.3 million</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>Development of capital markets in Viet Nam</td>
<td>2007–2013</td>
<td>€3 million</td>
</tr>
<tr>
<td>GIZ</td>
<td>Financial System Development (including risk management for banks and bond market development: bond swaps, new bond product development, CCP, cash settlement for securities via the SBV)</td>
<td>2011–2014</td>
<td>€1.2 million</td>
</tr>
<tr>
<td><strong>Finance</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>World Bank</td>
<td>Second Payment System and Bank Modernization Project</td>
<td>2005–2010</td>
<td>$105 million</td>
</tr>
<tr>
<td></td>
<td>Financial Sector Modernization and Information Management System Project</td>
<td>2009–2014</td>
<td>$55 million</td>
</tr>
<tr>
<td>Development Partner</td>
<td>Project Name</td>
<td>Duration</td>
<td>Amount</td>
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<tr>
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<td>------------------------------------------------------------------------------</td>
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<tr>
<td></td>
<td>Rural Finance III Project</td>
<td>2009–2014</td>
<td>$185 million (credit line)</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>$15 million (TA)</td>
</tr>
<tr>
<td><strong>Human Resource Development</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>USAID</td>
<td>STAR Plus Project on improved fiscal transparency, including support to SBV capacity building</td>
<td>2010–2013</td>
<td>$10 million</td>
</tr>
<tr>
<td>SECO</td>
<td>Bank Director’s Training Phase II</td>
<td>2013–2016</td>
<td>SwF2.33 million</td>
</tr>
<tr>
<td></td>
<td>Bilateral Assistance and Capacity Building Program for Central Banks</td>
<td>2012–2016</td>
<td>SwF8.7 million (globally)</td>
</tr>
<tr>
<td></td>
<td>Financial Programming</td>
<td>2013–2016</td>
<td>SwF3 million (globally)</td>
</tr>
<tr>
<td><strong>Investment Fund</strong></td>
<td></td>
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</tr>
<tr>
<td>AFD</td>
<td>TA for the Investment Funds for Urban Development of Ho Chi Minh City</td>
<td>2008–2014</td>
<td>€1.5 million</td>
</tr>
<tr>
<td></td>
<td>Second Credit Line to the Investment Funds for Urban Development of Ho Chi Minh City</td>
<td>2011–2014</td>
<td>€20 million</td>
</tr>
<tr>
<td></td>
<td>TA to Danang and Can Tho Investment Funds</td>
<td>2010–2015</td>
<td>€0.5 million</td>
</tr>
<tr>
<td></td>
<td>Credit Line to Danang and Can Tho Investment Funds for Financing of Projects</td>
<td>2010–2015</td>
<td>€20 million</td>
</tr>
<tr>
<td><strong>Financial Inclusion and SME financing</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>AFD</td>
<td>Financial support to development of PCF network in poor regions and strengthening the CCF–PCF network TA to the Cooperative Bank:</td>
<td>2009–2014</td>
<td>€20 million</td>
</tr>
<tr>
<td></td>
<td>Institutional Support to PCFs (including risk management)</td>
<td>2009–2014</td>
<td>€0.5 million</td>
</tr>
<tr>
<td>World Bank</td>
<td>Access to Financial Services/Financial Inclusion (TA)</td>
<td>2011–2015</td>
<td>$2 million</td>
</tr>
<tr>
<td>IFC/SECO</td>
<td>Microfinance Program (including policy and regulatory advisory, and support to MFI development)</td>
<td>2012–2016</td>
<td>$4 million</td>
</tr>
<tr>
<td>SECO</td>
<td>Green Credit Trust Fund</td>
<td>2007–2017</td>
<td>$5 million</td>
</tr>
<tr>
<td>JICA</td>
<td>SME Finance Project III</td>
<td>2009–2013</td>
<td>¥17,379 million</td>
</tr>
<tr>
<td><strong>Risk Management</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GIZ</td>
<td>Financial System Development (including risk management for banks, and bond market development: bond swaps, new bond product development, CCP, cash settlement for securities via the SBV)</td>
<td>2011–2014</td>
<td>€1.2 million</td>
</tr>
<tr>
<td>IFC</td>
<td>Risk Management</td>
<td>2007–2013</td>
<td>$0.7 million</td>
</tr>
<tr>
<td>SECO</td>
<td>Environmental and Social Risk Management (advisory support to the SBV in developing respective guidelines/indicators)</td>
<td>2012–2017</td>
<td>$1.5 million</td>
</tr>
</tbody>
</table>

*continued on next page*
### Appendix 3 Table  continued

<table>
<thead>
<tr>
<th>Development Partner</th>
<th>Project Name</th>
<th>Duration</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Financial Infrastructure Development</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>IFC/SECO</td>
<td>Secured Transactions Legal Framework</td>
<td>2008–2016</td>
<td>$1 million</td>
</tr>
<tr>
<td>SECO</td>
<td>Financial Infrastructure Development (including credit bureau and payment system)</td>
<td>2011–2016</td>
<td>$1.35 million</td>
</tr>
<tr>
<td><strong>Money Market Development</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>US Treasury</td>
<td>Repo market development and monitoring liquidity</td>
<td>Since 2009</td>
<td></td>
</tr>
<tr>
<td><strong>Supervision Inspection</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CIDA</td>
<td>Banking regulation and supervision support</td>
<td>2013–2018</td>
<td>Can$14 million</td>
</tr>
<tr>
<td><strong>Monetary/Exchange Rate Policies</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>IMF</td>
<td>Guidance on monetary instruments and operations</td>
<td>Since 2004</td>
<td></td>
</tr>
<tr>
<td>GIZ</td>
<td>Advice on monetary and exchange rate policies</td>
<td>Since 2005</td>
<td></td>
</tr>
<tr>
<td>US Treasury</td>
<td>Using the liquidity table, setting objectives and targets of monetary policy</td>
<td>Since 2009</td>
<td></td>
</tr>
<tr>
<td><strong>Statistics and Database</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>IMF</td>
<td>Monetary and financial statistics compilation</td>
<td>Since 2010</td>
<td></td>
</tr>
<tr>
<td></td>
<td>BOP statistics compilation and regulation</td>
<td>Since 2010</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Financial Soundness Indicators</td>
<td>Since 2010</td>
<td></td>
</tr>
<tr>
<td><strong>Issuance and Vault Operation</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>JICA</td>
<td>Project for Strengthening Functions of the SBV focusing on issuance and vault operations</td>
<td>2010–2013</td>
<td></td>
</tr>
<tr>
<td><strong>Anti-Money Laundering</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>IMF</td>
<td>Anti-money-laundering</td>
<td>Since 2010</td>
<td>SwF0.99 million (regional)</td>
</tr>
<tr>
<td>SECO</td>
<td>Anti-money-laundering and countering financing of terrorists</td>
<td>2011–2013</td>
<td></td>
</tr>
</tbody>
</table>


Note: Given the number of active development partners in the financial sector, only a limited number of projects is included.

Sources: Asian Development Bank, Viet Nam Resident Mission.


<table>
<thead>
<tr>
<th>Year</th>
<th>Title</th>
<th>Details</th>
</tr>
</thead>
</table>


2012f. Decision No. 254/QD-TTg of 1 March 2012 of the Prime Minister approving the Scheme to Restructure the System of Credit Institutions during the period 2011–2015. Ha Noi.

2012h. Decision No. 572/QD-NHNN of 30 March 2012 of the Governor of the State Bank of Viet Nam approving the Plan to Implement the Microfinance Sector Development Project in Viet Nam up to 2020. Ha Noi. http://www.sbv.gov.vn/portal/faces/en/enlinks/endetail/enct409?dDocName=CNTHWEBAP01162514298&_afrrLoop=75233542683000&_afrrWindowMode=0&_afrrWindowId=null%3Dnull%26_afrrLoop%3D75233542683000%26DocName%3D%26%26DocName%3D%26af.ctrl-state%3D1bc43uob0b_4


2013g. Circular No. 166/GP-NHNN of 4 June 2013 of the Governor of the State Bank of Vietnam on a License to Establish and Operate the Cooperative Bank of Vietnam. Ha Noi. http://sbv.gov.vn/portal/faces/vi/vilinks/vicm101/vict101;jsessionid=GbrR52XDN4V4rDNAjKgX2Z2L1QhGnfbLtwc2yj0n3MntmQCD!-453879207!-856020250?dDocName=CNTHWEBAP01162518842&_afrLoop=242798470737500&_afrWindowMode=0&_afrWindowId=Null##%40%3F_afrWindowId%26%26_afrLoop%3D242798470737500%26%26DocName%3D242798470737500%26%26fWindowMode%3D0%26_adf.ctrl-state%3D18mnvuhs80_4


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2014f. Decision No. 366/2014/QD-TTg of 11 March 2014 of the Prime Minister approving a Plan to Form and Develop a Vietnamese Derivatives Securities Market. Ha Noi.


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Viet Nam: Financial Sector Assessment, Strategy, and Road Map

This sector assessment, strategy, and road map highlights the Government of Viet Nam’s plans and strategies for addressing priority needs for the financial sector and identifies possible preliminary areas of international assistance. It assesses key sector development needs by analyzing strengths, constraints and weaknesses, various risks, potential threats, as well as opportunities. This knowledge product serves as a basis for further dialogue on how the Asian Development Bank and the government can work together to tackle the challenges of managing financial sector development in Viet Nam in the coming years.

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ADB’s vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries reduce poverty and improve the quality of life of their people. Despite the region’s many successes, it remains home to approximately two-thirds of the world’s poor: 1.6 billion people who live on less than $2 a day, with 733 million struggling on less than $1.25 a day. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

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