PROGRAM IMPACT ASSESSMENT

I. Summary

1. This Program Impact Assessment (PIA) describes the benefits and costs of the Financial Sector Deepening Program — Subprogram 2 (FSDP–SP2) on the money markets and capital markets of Viet Nam and the wider Vietnamese economy. The assessment starts with a brief review which identifies a number of problems that are facing the financial sector (and the impacts of these problems on the wider Vietnamese economy), and then outlines the key components of the program and the ways in which these program components affect the money and capital markets. It quantifies the costs and benefits associated with the program.

2. The quantified net benefits of FSDP–SP2 are estimated to be USD246 million. The quantified benefits are assessed to be USD1,900 million most of which arise through a 20 basis point reduction in the cost of the Viet Nam Government's debt — stemming from a drop in its risk premium. This 20 basis point reduction is estimated to deliver a discounted net benefit of USD1,300 million. In addition, there will be benefits from compliance with Basel II. Importantly, there are other benefits of FSDP–SP2 that have not been quantified. Some benefits accrue to improvements in resource allocation that the reforms will promote, while some reforms represent building blocks for more substantial reforms that, if implemented, will deliver substantial economic benefits in their own right.

3. The costs of FSDP–SP2 are estimated to be USD1654 million. These costs include costs to the Viet Nam Government associated with: issuing debt of longer tenors; increasing the capital of the Viet Nam Asset Management Company; and administration costs to government agencies such as State Bank of Vietnam (SBV), the Ministry of Finance (MOF), the State Securities Commission (SSC) and the Ha Noi and Ho Chi Minh stock exchanges. There are also costs to the private sector. These are compliance costs associated with meeting Basel II requirements and other reporting and information disclosure requirements stemming from the FSDP-SP2 reforms.

II. Development Problem and Constraints

5. **The legacy of central planning.** Despite substantial market-oriented reform in recent years, the legacy of central planning still weighs heavily on Viet Nam, not least on its financial institutions and financial markets. In most areas of the economy, markets are now the main mechanism of resource allocation. However, their ability to deliver efficient outcomes is often hampered by inadequate institutional architecture in the finance sector.

6. Well developed and efficient financial markets are central to economic development. They allocate savings and other investment funds into areas of the economy that are likely to achieve the highest rates of return, thus enhancing resource allocation and promoting economic growth. Further, a strong financial system helps countries weather international financial crises. Viet Nam's relatively underdeveloped financial architecture and financial markets therefore not only constrain the country's economic potential, but translate into higher perceived risks of operating in Viet Nam's financial markets. These risks are reflected in higher risk premiums attached to investments in Viet Nam — raising borrowing costs to users of capital, such as the government and the business sector.

7. Viet Nam's relatively underdeveloped financial architecture and associated markets manifest themselves first and foremost as a risk premium on borrowed funds. The government

is at a heightened risk of default if the financial sector and economy are fragile and likely to require support during a period of crisis. Investors realise this and they price government debt accordingly. The implied risk premium takes the form of higher debt servicing costs, which are ultimately borne by taxpayers.

8. A second cost imposed by inefficient financial markets is that investment is lower and less well directed than it otherwise would be. The financial sector — dominated by state owned banks — is not conducive to the efficient intermediation of funds into productive investment, in part because of a relatively high level of government ownership and intervention — another legacy of central planning. Ample evidence is provided by the very high level of non-performing loans on the books of state-owned commercial banks.

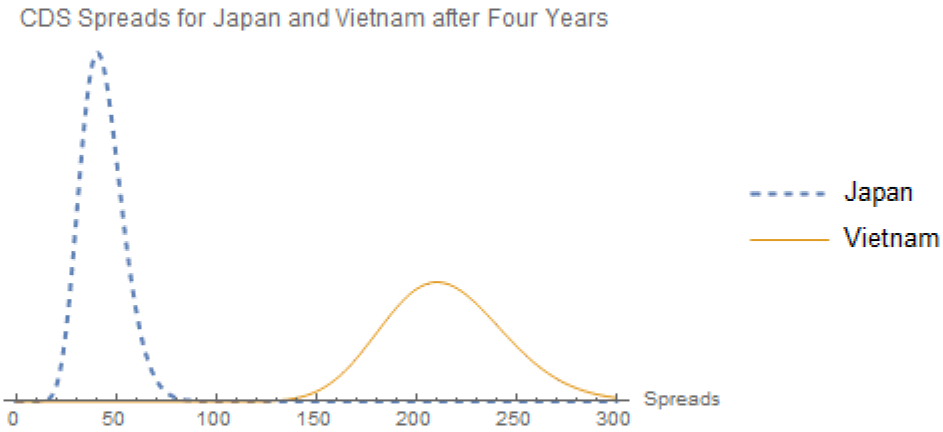
9. Financial sector reforms are central to the achievement of the government's broad economic development objectives. Viet Nam's Socio-Economic Development Plan (SEDP), 2011–2020 is designed to convert Viet Nam into a modern, productive, and equitable market-based economy. In particular, the SEDP seeks to increase the role of the nonbank financial sector and deepen the financial markets in order to sustain the financing of productive investment.

10. **Viet Nam lags its neighbours in financial sector indicators.** Viet Nam's relatively underdeveloped institutional architecture and financial markets are reflected in international comparisons. For example, Viet Nam consistently receives lower sovereign ratings than its regional neighbours. Viet Nam has the lowest Standard & Poor's Foreign Rating of the following south east asian countries: Malaysia (A- outlook stable); Thailand (BBB+ outlook stable); Philippines (BBB outlook stable); Indonesia (BB+ outlook positive); and Viet Nam (BB- outlook negative). In recognition of this low level of creditworthiness, its government debt also posts the highest implied default risk in credit default swap spreads (CDS spreads).

11. Compared to most of its regional neighbors — Thailand, Malaysia, Indonesia and the Philippines for example — Viet Nam's money market, government bond market, corporate bond market and stock market are small. The small size of these markets is a significant limiting factor on the ability of the government and private sector businesses to raise capital through these avenues.

12. The World Economic Forum's *Global Competitiveness Report 2014-15* identified the most problematic factor for doing business in Vietnam as 'access to financing', with corruption a distant second. The report ranked Viet Nam 104th (out of 144 countries) for 'availability of financial services', 115th for 'affordability of financial services', 132nd for 'soundness of banks' and 110th for 'regulation of securities exchanges'. Yet surplus capital is abundant: Viet Nam ranks 29th in terms of gross national savings, measured as a percentage of GDP (World Economic Forum 2015).

13. Vietnamese debt is perceived to be very risky. CDS spreads for government debt – a barometer of sovereign default risk in securities markets – are usually the highest in East Asia. The graph below compares the probability distribution of those spreads for Japan (left-hand side) and Viet Nam (right-hand side) over a four-year forecast horizon. Viet Nam not only has much higher spreads on average, as shown by the higher value at which the curve peaks, but the flatter shape of the curve indicates that investors are very uncertain about its prospects. The fact that the curve assigns higher probabilities to a wider range of outcomes means that perceptions of instability in Viet Nam could linger for much longer than they would in Japan.



14. **Institutional and regulatory factors.** Viet Nam's financial markets feature a complex array of institutional and regulatory factors that have been inhibiting its performance and growth. These factors include weaknesses in financial infrastructure, such as poor financial reporting standards and deficiencies in financial regulation and supervision. There have also been episodes of counterproductive interference by central and local authorities in the investment and credit decisions of state owned enterprises and state owned commercial banks.

15. **Banking sector.** The Vietnamese banking sector is relatively large for a low middle-income country, with assets equivalent to 183% of GDP in 2011. However, it dominates the financial system and is itself dominated by state-owned commercial banks as the participation of the government in the commercial banking system extends further taking into account the equity participations of the state, state-owned enterprises and state-owned commercial banks in several of the 34 joint-stock banks. In general, state-owned commercial banks provide large amounts of scarce credit, often at subsidized rates, to poorly performing state-owned enterprises, thereby limited the supply of credit to the private sector. The performance of the banking sector has deteriorated in recent years and is probably weaker than reported. The average return on assets of all banks fell from 1.8% in 2007 to 0.5% in 2012, with the latter figure probably overstated given the low quality of financial data (World Bank 2014).

16. The ability of the banking sector to intermediate is currently limited by high levels of nonperforming loans (NPLs), undercapitalization, and a suboptimal allocation of resources. The most recent International Monetary Fund Article 4 Consultation, dated October 2014, estimated aggregate NPLs in the banking sector at just over 4% of total loans. However, in 2013 Fitch Ratings estimated system aggregate NPLs at 15% of total loans. Many small banks have experienced more serious liquidity and solvency problems in the same period, leading to interventions by the SBV.

17. **Nonbank financial sector.** The nonbank financial sector, which represents an alternative source of intermediation of long-term credit needs, remains embryonic. Non-banking financial institutions are equivalent to just 17% of GDP and represent only 8% of financial institution assets. The corporate fixed-income market has been growing but is still very small. It is also highly concentrated — with the 15 largest issuers being responsible for all corporate bonds outstanding — and illiquid as illustrated by high bid–ask spreads. Development of the currently underutilized stock and corporate bond markets could help provide a more reliable supply of long-term funding to the private sector.

18. **Money market.** Viet Nam's money market is also relatively underdeveloped, segmented and unstable, as evidenced by quotations in the interbank market. Most banks quote a one-way price or wide bid–offer spreads. Activity in the market appears to be adversely affected by an overly-restrictive regulatory regime and a lack of confidence in government policy setting. Reforms are needed in order to enable the money market to properly fulfil its functions, namely enabling: financial institutions to match short-term assets and liabilities; security dealers to finance their inventories and make two-way markets; corporations to smooth out working capital needs; the central bank to conduct more effective monetary policy; and the market to price financial instruments based on short-term benchmark rates.

19. While some recent reforms have increased the volume of interbank lending, reliable, market driven short-term benchmark interest rates need to be established, and the government also needs to provide an enabling environment for interbank lending and rationalize the overly restrictive regulatory framework.

20. **Government bond market.** Viet Nam's bond market is also relatively undeveloped. Despite some recent growth, the local currency bond market amounted to only 22.0% of gross domestic product (GDP) as at December 2014, still well below the emerging East Asia average of 57.8%. Despite some encouraging reforms in recent years, further reforms are needed to increase liquidity, standardize maturities, reduce fragmentation, lengthen average maturities, increase transparency, stabilize the regulatory environment and improve institutional supervisory capacity. In particular, a yield curve needs to be established in order to promote the development of a corporate, derivative, and structured finance market. Despite some tightening of bid–ask spreads in 2013, Viet Nam continues to exhibit the widest bid–ask spreads in emerging East Asia, along with low transaction sizes and counts, reflecting a liquidity premium.

21. **Capacity of public and private institutions.** In the long run, there is a need to increase the fiscal and operational autonomy of the SBV, as well as its technical capacity. The organization has multiple objectives and its independence is limited, compromising its ability to exercise the supervisory powers that are granted by legislation. The effectiveness of supervision is also undermined by serious gaps in the regulatory framework — such as a lack of consistency with international standards, particularly in the areas of capitalization and reserves. Banking regulation and supervision are still underdeveloped and face substantial challenges. The level of compliance with the Basel Core Principles is low. High costs and a lack of data are reportedly preventing Vietnamese banks from meeting the 2015 deadline set for the implementation of Basel II regulations (KPMG 2013).

22. Deficiencies in Viet Nam's financial infrastructure also hamper development; foremost being the tendency to over-manage the economy. For example, the government may need to gradually relax various state-sponsored mechanisms that provide directed credit at predetermined rates. The government securities settlement system needs to be upgraded in order to reduce credit risk in the wholesale market. Broad capacity development is required to boost further the effectiveness of supervision and to strengthen the formal investor and consumer protection mechanisms necessary for financial market confidence. Finally, increasing interconnectedness within the financial system and between banks and the real economy will require better systemic risk monitoring and macroprudential policy, and further restructuring of state-owned enterprises to reduce the related drain on available capital resources.

23. **Progress of reform.** The government remains committed to financial sector development. It represents a key aspect of the reform agenda under the SEDP. The government recognizes that the equity and corporate bond markets represent essential sources

of financing for recapitalizing the banking system, and for equitized SOEs as state subsidies are slowly withdrawn. Efforts to address the large overhang of NPLs and to strengthen the banking system have begun to gain momentum. By the end of 2014, the Viet Nam Asset Management Company had purchased VND 123 trillion (USD5.7 billion) of NPLs from the banking sector although disposals have been minimal due to the entity's limited powers. The government has also begun restructuring SOEs to reduce the dominance of inefficient state production and promote private sector development.

24. **ADB contribution.** Recognizing the catalytic role markets play in economic development, ADB has supported financial sector development with a series of programmatic policy-based loans, coupled with significant levels of policy dialogue and technical assistance, all dating back to 1996. These have transitioned Viet Nam to a nascent, market-based financial system. Initial efforts introduced the basic concepts and systems for banking including a legal framework, negotiable instruments and secured transactions. Next, ADB supported the introduction of competition to the banking sector and initiated the development of the nonbanking sector to increase market-based financial intermediation. The next stage focused on increasing market liquidity and lowering transaction costs, the establishment of a public debt management office, strengthening investor and consumer protections, and operationalizing the country's Anti-Money-Laundering Information Center.

25. The completion of FSDP-SP1 sought to bring a more narrow focus to specific development constraints and has produced tangible results. Viet Nam's total local currency bonds outstanding grew 43.1% year-on-year to reach VND866 trillion (USD38.0 billion) as at December 2014. In fact, Viet Nam was the fastest growing local currency bond market in emerging East Asia in the fourth quarter of 2014 (quarter-on-quarter and year-on-year). Policy reforms have also increased activity in the money market. The level of nonbank financing has expanded as local currency bonds have increased to 22% of GDP from 16% in 2010, while total outstanding government bonds held by the contractual savings sector have increased to 14% from 11% in 2010. The average maturity of the government securities portfolio has been extended by the continuing issuance of longer tenors. The stock market exhibits similarly promising trends while liquidity in the equity and bond market has improved.

III. Reform Program

26. Recognizing the long-term and sequenced nature of the reforms, FSDP-SP2 continues ADB's programmatic support to increase the role of the nonbank financial sector in financing productive economic activities. The outcome remains "strengthened investor confidence". The three enabling outputs of FSDP-SP2 — designed to address the problems and constraints outlined above — which are: a well-functioning money market; a deeper and more liquid capital market; and improved capacity of public and private institutions in the financial sector.

27. **A well-functioning money market.** FSDP-SP2 introduced measures to enhance coordination to ensure the development of financial markets, and the money market in particular is well coordinated across stakeholders. Provisional short-term benchmark interest rates have been established at 30, 60, 90 and 180 days. Bank prudential liquidity standards, as well as expectations of risk management, have been increased which will increase demand for access to a liquid and well-functioning money market. Real-time trade monitoring and post-trade reporting for interbank foreign exchange transactions has increased transparency and investor confidence and will be followed by similar reforms in the domestic inter-bank market.

28. **A deeper and more liquid capital market**. Financial stability is a necessary precondition for capital market development. Recognizing this relationship, the Government has initiated institutional reforms to address elevated levels of systemic risk in the financial sector. Priority recommendations of the recent Financial Sector Assessment Program are being implemented. The progressive adoption of Basel II for large domestic banks will increase capitalization, strengthen risk management, and reduce systemic risk. The government has also improved its NPL resolution framework and has strengthened the bankruptcy code in favour of creditors.

29. At the same time, the government introduced a basic framework to accelerate development of the bond market. MOF has identified specific government bonds which will serve as short-term and long-term benchmarks. Fragmentation has been reduced and the maturity of the government debt portfolio has been extended by continuing regular issuance at 10 and 15 year tenors. The government developed a framework to launch a primary dealer system composed of 'bidding members', identified their basic rights and obligations, and established an annual review and ranking of the participants. Complementary reforms have been enacted to strengthen the government's supervisory powers and increase transparency. To deepen international linkages and cooperation, the SSC became a signatory to IOSCO's Annex A and authorized the formation of credit rating agencies.

30. **Improved capacity of public and private institutions in the financial sector.** The government has begun a number of long delayed reforms that will embrace international standards. MOF will progressively align Vietnamese accounting standards to International Accounting Standards, including the concept of market or 'fair' value. MOF, through SSC, the Viet Nam Securities Depository, and SBV will transfer the cash settlement leg of government bond transactions from a commercial bank to SBV and develop a limited purpose central clearing counterparty to support the introduction of derivatives trading. MOF, through SSC has published corporate governance rankings of publicly listed companies by group using the ASEAN Corporate Governance Scorecard and completed a draft plan to establish an Institute of Directors to advocate and support reforms to corporate governance. Finally, the government has continued to strengthen the capacity of line institutions responsible for financial sector development and supervision.

IV. Estimations of the Benefits and Costs of the Reforms

31. Table 1 summarizes the main features of the reforms that the staff have identified for EPPIP. These benefits are not exhaustive, but provide an indication of the key impacts.

Table 1: Summary of economic impacts of FSDP-SP2 reforms

	Enabling Outputs			**Summary of Economic Impact**
Name of reform	**Output 1**	**Output 2**	**Output 3**	
SBV issuing SBV bills with tenors of 28, 56, 91 and 182 days	*			Supports development of a permanent short term yield curve. Increases liquidity and lowers transactions costs.
SBV authorising derivatives on listed stocks, indices and government bonds.	*			Supports the introduction of derivatives such as foreign-exchange (FX) cross-currency swaps. Lowers transactions costs.

	Enabling Outputs			Summary of Economic Impact
Name of reform	**Output 1**	**Output 2**	**Output 3**	
SBV publishing domestic interbank rates, volumes and historical data on its website & established real time trade monitoring and post-trade reporting for domestic interbank transactions.	*			Increased transparency of money market transactions. Increases information and enhances efficiency.
SBV implements required stronger prudential liquidity management in banks, modelled on Basel 3.	*			Increased confidence in banks and banking system. Lowers cost of capital via reduction in risk premiums.
SBV adopts the standardized approach of Basel II for large domestic banks		*		Increased capitalization and strengthened risk management in the banking sector. Lowers the cost of capital via reduction in risk premiums.
VAMC's capital lifted fourfold and authorized to issue its own debt to purchase NPLs at market value, sell assets to non-residents.		*		Foundation upon which to begin addressing NPLs, paving the way for an eventual reduction in systemic risks arising from poor credit quality – and facilitating an improved allocation of resources to more productive ventures.
Government continued to issue identified benchmark securities, particularly of 10 and 15 year tenors.		*		Deeper, less fragmented and more liquid bond market. Increased liquidity, increased confidence, reduction in risk premiums.
HNX utilizes indicative prices to build a government bond yield curve and publishes quarterly and annual debt auction schedules on its website.		*		Increased information, greater confidence and lower transactions costs.
MOF/SSC strengthened reporting and information disclosure by public companies.		*		Greater transparency increases stock market's attractiveness to investors, ultimately increasing its potential as a source of capital.
MOF adopts a system of sanctions for violations of the Law on Accounting and the Law on Independent Audit.		*		Strengthened supervisory powers leading to increased confidence in securities trading, lowering risk premiums.
The government authorized the formation of foreign and domestic credit rating agencies and provided governance standards.		*		Increased information to investors, leading to increased confidence, lowered risk premiums and greater attractiveness to foreign investors.
MOF drafted an amended Law on Accounting to progressively base Viet Nam Accounting Standards on International Accounting and Reporting Standards.			*	Introduction of international standards in the areas of governance and investor protection will improve investor confidence, lowering risk premiums and the cost of capital.
Action plan submitted to MOF and Prime Minister for merging HNX and HOSE.			*	Paves the way for economies of scale, lowered transactions costs and efficiency gains.
MOF, through SSC, VSD, and SBV developed an action plan to transfer cash settlement leg of government bond			*	Building block towards increased supervisory capacity of line institutions, ultimately increasing investor confidence and lowering risk premiums and the cost of capital.

	Enabling Outputs			Summary of Economic Impact
Name of reform	**Output 1**	**Output 2**	**Output 3**	
transactions to SBV and develop a central counterparty clearinghouse to support introduction of derivatives trading.				
MOF increased capacity to complete debt sustainability assessments.			*	Increased supervisory capacity of line institutions increases investor confidence, lowering risk premiums and the cost of capital
SBV invests in the skill base of its staff.			*	Increased supervisory capacity increases investor confidence, lowering risk premiums and the cost of capital

32. **The base case against which FSDP-SP2 is assessed.** The impacts of FSDP-SP2 are assessed against the institutional architecture and policy settings before FSDP-SP2 commenced — that is, at September 2013. These represent the base case against which the impacts of EPPIP are measured. Efficiency gains from FSDP-SP2 arise in three main ways.

33. <u>Lowered borrowing costs.</u> First, the reforms should lead to lower borrowing costs for users of capital in the government sector and, ultimately, in the private sector. This benefit will arise from perceptions of lower risks associated with Viet Nam's financial markets — the result of increased transparency, greater liquidity, improved prudential requirements, improved regulatory settings and strengthened enforcement of regulatory requirements.

34. <u>Improved resource allocation.</u> Second, the reforms should improve the efficiency with which Viet Nam's financial markets direct capital to productive business enterprises. Several of the reforms will lead to improved allocation of Viet Nam's strong domestic savings, as well as foreign capital, into productive ventures — for example, by improving investor confidence in the non-bank financial sector, including the stockmarket and corporate bond market.

35. <u>Enhanced macroeconomic stability.</u> Third, the reforms should strengthen the ability of Viet Nam's financial markets — and its economy more broadly — to withstand external shocks. This will occur through increased market liquidity, improved investor confidence and a strengthened capability of the SBV to undertake monetary policy more effectively (through the money market). The reforms will also ease the risks posed by the over-reliance on the bank-dominated financial sector and thus help to pave the way towards a more diverse and stable financial base.

A. The Benefits of FSDP-SP1

36. The benefits will stem from the 25 completed policy actions associated with the three primary outputs of the FSDP-SP2: a well-functioning money market; a deeper and more liquid capital market; and improvements in the capacity of public and private institutions in the nonbank financial sector. Many of the 25 completed policy actions contributed directly to the financial sector and the broader economy. Others, such as institutional capacity building, contributed in equally important but indirect ways.

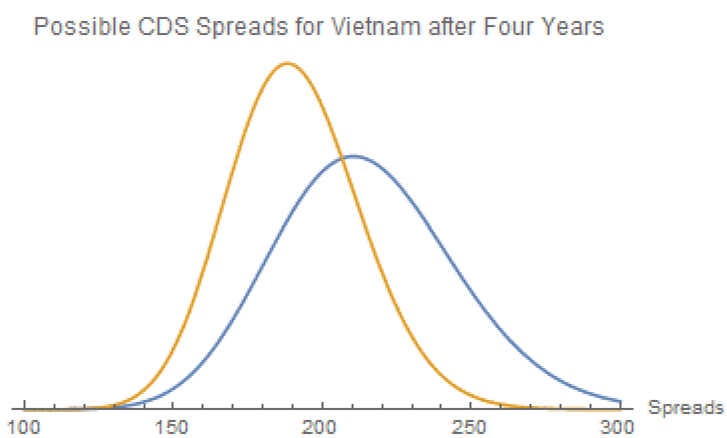
37. The reforms have had the following impacts: deeper and increased liquidity in the bond and money markets; standardized maturities and reduced fragmentation in the bond and money markets; lengthening of the yield curve; increased transparency; a more stable regulatory

environment; improved institutional supervisory capacity; increased confidence of market participants (domestic and foreign) across all parts of the financial sector; and an increase in systemic stability. The reforms also begin to address the capital misallocation impacts and systemic risks associated the banking sector's large stock of NPLs.

38. **Benefits to the Government of Viet Nam.** Most of the economic benefits of FSDP-SP2 arise through a projected 20 basis point reduction in the cost of the Viet Nam Government's debt through a reduction in the implied risk premium.

39. Credit default swap (CDS) spreads reflect a premium that is charged to a borrower for its risk of default. When applied to a government, CDS spreads are a broad and summary indicator of systemic stability. The higher the spread, the greater the compensation that investors require for bearing the risk of a government being unable to repay its debt. In reasonably open financial markets, the premium that is observable on a government's external borrowings (for example, in Eurodollars) is likely to explain some of the yield on its domestic borrowing. Reductions in the CDS spread should therefore flow through to a lower cost of debt service on domestic debt. This PIA estimates those lower costs as being 20 basis points on a five year Vietnamese Government bond.

40. Applying standard statistical models of default risk to Vietnamese data illustrates the impact. The graph below shows some estimates of the distribution of possible outcomes for the CDS spreads with and without reform of the markets. These curves have been estimated with a common statistical model and a history of Viet Nam's data. In the graph, each line is a probability distribution. The higher the line, the greater the likelihood of the corresponding spread at a time horizon of four years. Reforms to financial markets not only reduce spreads by shifting the curve to the left but also make high values less likely. This is because mature financial systems are recognised as being more able to bounce back from temporary disturbances, so perceived default risk is less likely to stray above its average value for long periods.



41. With reform of the capital markets, credit spreads should be lower and more predictable than they would be without capital market improvement. The leftward shift in the curve represents a reduced cost of debt to the government. The tightening in the range of outcomes — that is the steepening of the curve — reflects the greater certainty of outcomes and is a benefit to bond issuers and bondholders alike. With the local currency bond market valued at USD38 billion at December 2014, at current yields a 20 basis point reduction in yields would deliver a discounted net benefit of USD1300 million.

42. Supporting this estimate is the measurable progress that has been made under FSDP-SP1 and under FSDP-SP2 so far. This includes 43% year-on-year growth in bonds outstanding (at December 2014), particularly at the long end (10 and 15 year bonds). There has also been a sizeable increase in money market activity, with average quarterly interbank turnover increasing to VND74.4 trillion in 2014, compared to just VND1.2 trillion in 2010.

43. **Benefits to the private sector.** Ten Vietnamese commercial banks have been chosen by the State Bank of Vietnam to pilot the application of international bank management standards in accordance with Basel II capital adequacy requirements (reform action 10). Costs of implementing Basel II are estimated at USD600 million. The primary benefit will be that borrowers are more effectively selected and their debt more efficiently valued. Such benefits are difficult to estimate with any degree of certainty but, for the purposes of this PIA, they have been assumed to at least equal the costs associated with meeting the standards — that is, around USD600 million.

44. The benefits associated with improved resource allocation have not been estimated for this PIA. Nonetheless, the reforms are assessed as delivering more efficient resource allocation, leading to increases in GDP. However, distinguishing the increases attributable to FSDP-SP2 from other influences on GDP is beyond the scope of this assessment. In any event, reforms that directly tackle the stock of NPLs and redirect the resources tied up in poorly performing state-owned commercial banks are likely to have a considerably greater impact than FSDP-SP2 in terms of resource allocation. Similarly, the benefits of reforms that constitute building blocks towards future reforms — for example, development of action plans and training of staff — have not been quantified in this PIA.

B. The Costs of FSDP-SP2

45. The costs of FSDP-SP2 comprise the costs to the Government of Viet Nam — the costs associated with raising debt at longer tenors, the costs of implementing and administering the 25 reforms, and the budgetary outlays for increasing the capital of VMAC — and compliance costs for Viet Nam's private sector financial institutions (table 2).

46. **Costs to the Government of Viet Nam.** There will be a substantial cost to the government from raising debt at longer tenors because the term structure in Vietnam is upward sloping. This implies that the discount on debt is increasing in its tenor. Based on current yields and on the uplift of issuance at the 10 and 15 year tenors in 2014, the implied total cost to the taxpayer in present value terms is VND72 billion (USD3.2 million).

47. The government will incur administrative costs in implementing the FSDP-SP2 reforms. The main agencies affected are SBV, MOF, SSC, HNX and HOSE. While it is possible that some of these administrative costs would be absorbed in the existing budgets of these government agencies as part of their core business, for the purposes of this PIA these costs have been assessed and estimated as additional government costs.

48. These administration costs include: SBV conducting legal survey of repo market impediments (reform action 5) — USD0.1 million; SBV publishing interbank rates and volumes on its website (reform action 6) — USD0.4 million; SBV establishing a working group to launch real time trade monitoring and post trade reporting of interbank transactions (reform action 6) — USD0.05 million; developing action plans for a financial stability and supervision of banking sector (reform action 9) — USD0.1 million; preparing a framework to deepen bond market

USD0.05 million (reform action 12); preparing a framework for introducing a primary dealer system (reform action 13) — USD0.05 million; State Securities Commission strengthening its enforcement capacity (reform action 16) — USD1 million pa (including costs of lawyers, statisticians, trading experts, monitoring software); drafting an amended Law on Accounting to align with international standards (reform action 19) — USD0.8 million; developing an action plan for merging the stock exchanges (reform action 20) — USD0.1 million; developing an action plan for transferring cash settlement of bond transactions from commercial bank to SBV (reform action 21) — USD0.2 million; publishing corporate governance rankings of publicly listed companies (reform action 22) — USD0.2 million; establishing a Management Board and Administration Board for the Policy Holder Protection Fund (reform action 23) — USD0.1 million to establish and USD0.5 million per year in running costs; MOF increased capacity to independently complete debt sustainability assessments (reform action 24) — USD0.4 million; and training for 4789 SBV employees (reform action 25) — USD0.2 million. The costs add up to one-off costs of around USD3.5 million and ongoing annual costs of USD1.5 million — a total of USD13.6 million in present value terms. In addition, the Government increased the capital of the Viet Nam Asset Management Company (VAMC) to VND 2,000 billion (USD100 million) from VND 500 billion (USD25 million), implying a budgetary outlay of USD75 million.

49. **Costs to the private sector of Basel II.** Ten Vietnamese commercial banks have been chosen by the State Bank of Vietnam to pilot the application of international bank management standards in accordance with Basel II governance standards (reform action 10). Costs of implementing Basel II are estimated at USD600 million. In terms of costs, a bank may have to pay from USD5 million to USD10 million for a framework for risk management and about USD50 million for information system equipment. However, as noted above, it is assumed there will be offsetting long term benefits of a similar magnitude to the banks involved.

50. Foreign exchange market participants will face compliance costs associated with the requirement to provide real time trade monitoring and post trade reporting for FX transactions (reform action 7). For each company affected, these costs are estimated at USD0.2 million per year in staff costs, plus a one-off fixed cost of USD0.5 million. Based on an estimated 60 or so commercial banks providing FX services (Nguyen and Nguyen 2010), these costs are estimated at USD12 million per year and a one-off fixed cost of USD30 million.

51. Listed public companies will face ongoing compliance costs associated with strengthened reporting and information disclosure requirements (reform action 15). These are estimated at around USD0.15 million per year for each of the more than 300 publicly listed companies, or around USD48 million per year.

Table 2: Costs of FSDP-SP2

Types of Adjustment Costs	Government and Statutory Agencies	Cost (USD million, net present value)
Administrative Costs	One-off fixed costs Ongoing costs (USD1.5 million per year)	USD3.5 million USD23 million
Other Fiscal Costs	Issuing debt at longer tenors Increase in VMAC's capital	USD3.2 million USD75 million
Private Sector Costs	Basel II compliance Trade monitoring and post trade reporting for FX transactions - one-off fixed costs - ongoing costs (USD12 million per year) Reporting and information disclosure requirements for listed companies (USD48 million per year)	USD600 million USD30 million USD184 million USD735 million
Total Costs of FSDP-SP2 (net present value)		USD1654 million

Source: ADB estimates.

C. Risks

52. The main identified risks to achieving the benefits of FSDP-SP2 are those associated with public financial management and corruption and any reduction in political will to implement reform. However, of the 25 policy actions of FSDP-SP2, 23 have already been completed and the other two partially completed, suggesting that there has been no reduction in the commitment of the Government of Viet Nam to reform the country's financial markets. In addition, the policy goals of Socio-Economic Development Plan 2011–2020 and the recent initiatives to formally monitor and track the implementation of priority recommendations of the FSDP provide further evidence of the government's commitment to reform.

Table Summary Program Impact Assessment

The primary outcome sought from FSDP-SP2 is strengthened investor confidence. This outcome is to be achieved through three channels of effect: a well-functioning money market; a deeper and more liquid capital market; and improved capacity of public and private institutions in the financial sector. FSDP-SP2 is assessed to deliver immediate and long run benefits in the form of lowered borrowing costs, improved resource allocation and enhanced macroeconomic stability, leading to higher levels of economic growth and more rapid attainment of the government's development goals.

Channel of Effect		**Impact on the Sector/Economy**		**Estimated benefits, Winners and Losers**
General	**Specific**	**Short to medium Term**	**Long Run**	
A well-functioning money market	Development coordination mechanisms strengthened; money market transactions promoted; regulatory framework enhanced	Development of a permanent short term yield curve, increased money market liquidity, lowered transactions costs, availability of derivatives products, increased transparency of transactions, and reduction in risk premiums	Increased confidence in money market and the banking system as a whole, leading to a reduction in borrowing costs. This in turn leads to an increase in investment and economic growth, and more rapid achievement of development goals	The estimated benefits are spread across the three channels of effect. Major beneficiaries will be private sector businesses through increased availability of capital — in terms of quantity and range of sources — and lowered costs of capital, allowing them to expand their operations more rapidly and efficiently than otherwise. Ultimately, this will lead to improved labour market conditions in terms of job availability and higher wages.
A deeper and more liquid capital market	Systemic risks addressed and financial stability enhanced; bond market development progressed; supervisory oversight, disclosure and market transparency improved	Increased capitalization and strengthened risk management in the banking sector, a foundation upon which to begin addressing NPLs, a deeper, less fragmented and more liquid bond market, increased information availability, lower transactions costs, increased investor confidence in bond market and stock market, and lower risk premiums	Lowered cost of capital via reduction in risk premiums, improved access to non-bank sources of capital such as the stockmarket and corporate bond market, some reduction in systemic risks and building blocks established for further reductions. These in turn lead to improved allocation of resources, increased attractiveness of capital market to domestic and foreign investors and, ultimately, an increase in investment and economic growth and the more rapid achievement of development goals	To the extent that capital is redeployed from inefficient state-owned enterprises (including the state-owned commercial banks), some employees in these firms may face retrenchment. However, given the improved efficiency of resource allocation and improved returns on investment, the labour market should strengthen overall, providing opportunities for any displaced employees. Reductions in the cost of government debt should free up government funds for additional expenditure, debt reduction or tax cuts.
Improved capacity of public and private institutions in the financial sector	Structural and operational framework strengthened; and institutional capacity strengthened.	Improved governance, agency supervisory capacity and investor protection improves investor confidence, lowering transactions costs and risk premiums and reducing the cost of capital	Increased investor confidence from improved financial sector architecture and an associated perception of lowered risks will lead to higher levels of investment, increased economic growth and the more rapid achievement of development goals	

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