



Progress Report on Tranche Release

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Socialist Republic of Viet Nam: Financial Sector
Program Loan II–Subprogram II

Asian Development Bank

CURRENCY EQUIVALENTS

(as of 16 November 2007)

Currency Unit	–	dong (D)
D1.00	=	\$00000.62
\$1.00	=	D16,069.50

ABBREVIATIONS

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
AFD	–	Agence Française de Développement (French Development Agency)
AMLIC	–	anti-money laundering information center
CA	–	certified accountant
CAR	–	capital adequacy ratio
CPA	–	certified public accountant
CSP	–	country strategy and program
DIV	–	Deposit Insurance of Viet Nam
FDI	–	foreign direct investment
FSPL	–	Financial Sector Program Loan
GDP	–	gross domestic product
HASTC	–	Hanoi security trading center
HFC	–	housing finance credit
HOSE	–	Ho Chi Minh City stock exchange
IFRS	–	International Financial Reporting Standard
IMF	–	International Monetary Fund
IOSCO	–	International Organization of Securities Commissions
IPO	–	initial public offering
JICA	–	Japan International Cooperation Agency
MOF	–	Ministry of Finance
MOJ	–	Ministry of Justice
NPL	–	non-performing loan
ODA	–	official development assistance
OTC	–	over-the-counter
PCF	–	people's credit fund
PRSC	–	poverty reduction support credit
PVI	–	PetroVietnam Insurance
RBC	–	risk-based capital
SEDP	–	socio-economic development plan
SSC	–	State Securities Commission
SBV	–	State Bank of Viet Nam
SME	–	small and medium-sized enterprise
SOCB	–	state-owned commercial bank
SOE	–	state-owned enterprise
SRO	–	self-regulatory organization
TA	–	technical assistance
VAA	–	Vietnamese Accounting Association
VACPA	–	Viet Nam Association of Certified Public Accountants
WTO	–	World Trade Organization

NOTE

In this report, "\$" refers to US dollars.

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I. INTRODUCTION

1. **Economy in Transition.** Viet Nam's financial sector is in transition. The Government has made persistent efforts to modernize and transform it, recognizing its significance to the country's economic performance. The level of financial intermediation is low, and is dominated by bank savings and loans. The banking system is unable to fully support economic development and generate employment. The Government has begun the financial and operational restructuring of the banking subsector with assistance from the International Monetary Fund (IMF) poverty reduction and growth facility (PRGF) and the World Bank under the poverty reduction support credit (PRSC) in June 2001. The Financial Sector Program Loan II (FSPL II) was formulated to complement this process. It addresses the need to develop alternative channels of financial intermediation to support Viet Nam's broad-based economic growth and socioeconomic development objectives, including poverty reduction.

2. **Financial Sector Program Loan II.** The Asian Development Bank's (ADB) Board approved the FSPL II consisting of subprogram I for \$50 million on 20 November 2002¹ and subprogram II for \$35 million on 3 December 2004.² FSPL II is financed by the Asian Development Fund (ADF) and cofinanced by the French Development Agency (AFD) for €35 million: €23 million for subprogram I and €12 million for subprogram II. The AFD cofinancing is disbursed in tranches at the same time as the ADB disbursements, according to the same schedule and conditions. The proceeds finance the costs of projects, which are directly linked to reforms in the financial sector.

3. Subprogram II builds on the achievements of subprogram I and aims to support the Government's efforts to develop alternative channels of financial intermediation, such as money and capital markets, insurance, leasing, and financial infrastructure to enhance public confidence. The development of the nonbanking subsector and the capital market is critical to the provision of the long-term funds and investment capital that are largely lacking in Viet Nam. More competition from the nonbanking subsector is expected to lead to greater efficiency. Subprogram II is designed to make the financial system as a whole broader, better balanced, and more resilient to external shocks. Its outputs will include (i) economic policies that are conducive to sound and vibrant financial sector development; (ii) legal and regulatory frameworks that will promote innovation and healthy competition while monitoring and reducing systemic risks; (iii) regulators with the authority, budget, skills, and established procedures to monitor and enforce regulations; and (iv) supporting financial infrastructure.

4. Subprogram II was declared effective on 15 March 2005 with funds from the ADF to be released in three tranches: (i) \$10 million equivalent upon compliance with the first tranche release conditions, (ii) \$15 million equivalent subject to fulfillment of second tranche release conditions, and (iii) \$10 million equivalent subject to completion of third tranche release conditions. The first tranche was released on 20 December 2005 and the second on 22 December 2006. Release of the third tranche, originally envisaged to be about March 2007, has been extended to 31 December 2007 as the Government asked for additional time to comply with all third tranche release conditions.

¹ ADB. 2002. *Report and Recommendations of the President to the Board of Directors on a Proposed Program Loan Cluster to the Socialist Republic of Viet Nam for the Financial Sector Program Loan II*. Manila.

² ADB. 2004. *Report and Recommendations of the President to the Board of Directors on a Proposed Program Loan to the Socialist Republic of Vietnam for the Second Financial Sector Program-Subprogram II*. Manila.

5. **Technical Assistance.** An ADB technical assistance project ³ supported the Government to comply with some of the policy conditions under subprogram II and another TA project ⁴ supported the implementation of subprogram I. Both TA projects covered the nonbanking subsector and capital markets. While FSPL II is extensive, requiring a multitude of policy reforms, the TA projects focused on a number of policy conditions that required additional technical inputs and capacity-building activities if they were to be complied with.

6. **Third Tranche.** The status of compliance with the third tranche policy actions under subprogram II was reviewed by ADB in detail in May and August 2007. Appendix 1 contains an overview of the compliance status of all 15 third tranche conditions, justifying the release of the third tranche of \$10 million equivalent.

II. MACROECONOMIC AND FINANCIAL SECTOR ISSUES AND DEVELOPMENTS

A. Macroeconomic Development

7. **Economic Growth.** Viet Nam is one of the fastest growing economies in Asia, recording an average annual growth in gross domestic product (GDP) exceeding 7% from 2001 to 2006. This is projected to grow to more than 8% during 2007–2010. Per capita GDP rose from \$415 to \$725 per year from 2001 to 2006. Compared with East Asian countries, Viet Nam's growth in this period is second only to China. Economic development was underpinned by rapid growth in private investment, strong consumption, and robust exports. Industry growth continues to average over 10% a year. Services growth, which has picked up since 2005, remained strong in 2006 and the first half of 2007, especially in retail and wholesale trade, hotels and restaurants, and financial intermediation. Growth in 2006 was driven by strong demand, including 20% growth in exports in dollar terms. In parallel, private investment and private consumption also recorded robust growth. Growth in private consumption was supported by rising incomes, and annual inward remittances of about \$4 billion.

8. **Socio-Economic Development Plan.** In 2006 the Government approved the new Socio-Economic Development Plan 2006-2010 (SEDP), which has as its goal the achievement of middle-income country status by 2010 and industrial country status by 2020. The SEDP also targets an increase in GDP per capita from about \$622 in 2005 to \$1,050-\$1,100 by 2010. While reaffirming the socialist orientation of the economy and promoting the prominent role of the state in investment-led growth, the SEDP also strongly emphasizes the objectives of business development, private investment, and a continuing transition towards a market-based system with greater integration with the global economy. The official development assistance (ODA) community has aligned its efforts behind the SEDP, while acknowledging that other key documents will shape reforms in the coming years. Such an alignment is a testament to the strong ownership of the reform program by the Government. It also reflects satisfaction with the process through which the SEDP was prepared. The SEDP is seen as both a credible and a sustainable strategy to foster economic growth and poverty reduction. ADB's country strategy and program⁵ 2007-2010 is consistent with the government's SEDP, and supports business-led pro-poor growth by promoting infrastructure development, a business-enabling environment, and more financial intermediation.

³ ADB. 2004. *Technical Assistance to the Socialist Republic of Viet Nam for Capacity Building for the Financial Sector and Capital Markets*. Manila.

⁴ ADB. 2002. *Technical Assistance to the Socialist Republic of Viet Nam for Capacity Building for Nonbank Financial Institutions and the Capital Markets*. Manila.

⁵ ADB. 2006. *Country Strategy and Program: Vietnam 2007-2010*. Manila.

Table 1: Major Economic Indicators, 2004–2008
(%)

Item	2004	2005	2006	2007e	2008e
GDP growth	7.5	8.1	8.0	8.3	8.5
Gross domestic investment/GDP	35.5	37.6	38.4	39.1	39.9
Inflation rate (average for the year)	7.7	8.2	7.5	6.8	6.3
Money supply (M2) growth	30.0	29.4	28.9	30.0	32.1
Fiscal balance/GDP	(3.8)	(2.8)	(5.0)	(5.0)	(5.0)
Merchandise export growth	33.1	22.5	23	19	20
Merchandise import growth	30.5	16	21	15	19
Current account balance/GDP	(5.7)	(3.6)	(2.1)	0.2	1.3
Debt service ratio	6.7	5.7	5.6	6.0	6.0

GDP = gross domestic product

Source: General Statistics Office; State Bank of Viet Nam; Ministry of Finance; International Monetary Fund; staff estimates.

9. **Fiscal Performance.** Viet Nam's entry to the World Trade Organization (WTO) in January 2007 is expected to expand the market for Vietnamese products and further promote economic reforms. The ratio of exports to GDP increased from about 55% in 2000 to 66% in 2006, indicating the openness of economy. Robust domestic demand, particularly from investment projects, caused imports to grow by 33.3% and as a consequence, the trade deficit was estimated at \$4.5 billion, equivalent to 8.7% of GDP in 2006. However, a vigorous expansion in both private remittances and tourism receipts helped to limit the current account deficit to \$1.26 billion, or 2.1% of GDP. ODA, robust foreign direct investment (FDI) inflows and foreign portfolio investments led to a surplus in the capital account and a rise in gross international reserves to \$11.5 billion, equivalent to 3.5 months of imports. Reserves are estimated to have risen by an additional \$3 billion in the first quarter of 2007. The overall fiscal deficit was 3.8% of GDP in 2006, slightly lower than the average 4.8% of the last 5 years. The total public debt stood at a manageable level of 44 % in 2006. Under a base case scenario, public debt is projected to rise over the next 5 years, but is expected to remain below 55%.

10. **Capital Inflow and Inflation.** Inflation continued to run at a rapid rate, exceeding 7% on average during 2006, for the third year in a row. Domestic credit grew by almost 42% in 2004 and by more than 30% in 2005. FDI capital inflows were about a record \$10 billion in 2006. Managing these capital inflows has posed new challenges for the Government, which took monetary measures to control inflation through the State Bank of Vietnam's (SBV) purchase of \$7 billion of foreign currency and the issuance of SBV-bills to sterilize 80% of this foreign exchange purchase. Import taxes on fuel and some other commodities were cut to reduce pressures on prices.

11. **Investment and Savings Rate.** The investment to GDP ratio was 35% in 2001 and rose to 41% in 2006. Viet Nam's aggregate savings rates, at about 36% of GDP in 2006, are lower than those in some other regional economies but they are rising. Savings rates are likely to continue increasing because of the country's favorable demographic profile. Viet Nam has one of the youngest populations in Asia with more than 65% of the population below 65 years of age. The median age of the population is expected to be only 29 years in 2015 (compared with 37 years in People's Republic of China), and the ratio of working to dependent population is

expected to continue rising in the medium term, which will have a favorable impact on aggregate savings ratio.

12. **Private Sector Development.** The share of the domestic private sector in total investment is increasing. In 2006, 46,663 new enterprises were established with a registered capital of D148 trillion (over \$9.2 billion), a 50% increase over the previous year. The accumulated number of enterprises registered under the Enterprise Law from 2000 to June 2007 was about 271,034 and these enterprises had a committed capital of D773 trillion (over \$48 billion). The record \$10 billion FDI inflow in 2006 was 65% higher than in 2005. A stable macroeconomic environment, continued improvements to the business environment, and low labor costs continue to attract foreign direct investment. Between 2000 and 2006, the private sector's share of non-oil exports rose from about 50% to 70%, while its share of manufacturing production rose from 57% to nearly 70%. The result has been massive job creation, allowing 1.4 to 1.5 million entrants to enter the labor market every year.

13. **Role of Nonbank Financial Sector.** The ability of the economy to sustain this high growth will need to be complemented by greater financial intermediation and more efficient resource allocation. Although the banking industry currently dominates the financial sector, the role of the nonbank financial sector will need to increase if Viet Nam is to meet its SEDP growth objectives. Reform of the banking and financial sector is critical if Viet Nam is to become globally competitive in the markets being opened to the world by the WTO. Viet Nam needs to ensure that structural reforms to strengthen the domestic financial sector are well sequenced, appropriately paced, and tailored to the specific circumstances of its economy as the financial sector is opened up internationally.

B. Financial Sector

1. Banking Sector

14. **Banking Sector Growth.** The banking sector continues to expand rapidly and Viet Nam's economy is becoming increasingly monetized. Net domestic assets increased by 30% in 2006. The ratio of M2 to GDP, which indicates the level of financial deepening, increased from 50% in 2000 to almost 79% in 2005 and to 95% in 2006. Total bank credit to GDP increased from 37% in 2000 to nearly 66% in 2005 and to 71% in 2006. The total banking sector asset base was D1,206,823 billion (\$75.43 billion) as of the end of 2006 and state-owned commercial banks (SOCBs) accounted for 67% of this. About 70% of all bank liabilities are with the SOCBs.

15. **Nonperforming Loans and Sector Performance.** SBV reports indicate that the performance of the banking sector improved significantly in 2006 with total nonperforming loans estimated at approximately 3% according to Viet Nam accounting standards and 7% according to international accounting standards. The issuance of Decision 493 on asset classification and loan loss provision in May 2005 helped realign Viet Nam's regulations with international standards. A first estimate of NPLs based on Decision 493 was produced in early 2006 after large write-offs of bad debts. This estimate places the NPLs in the range of 7% to 9% of total credit.⁶

16. **Capital Adequacy** SBV requires banks to adhere to the Basel Core Principles of 8% capital adequacy ratio (CAR) in relation to their total risk-weighted assets. All joint stock

⁶ World Bank. 2007. *Viet Nam Development Report*. Washington.

commercial banks have CARs ranging between 8% and 10%, given their increase in equity capital in 2006. Among SOCBs, only Vietnam Bank for Agriculture and Rural Development's CAR is less than 8%.

17. **SOCB Equitization.** Reform of the SOCBs is being accelerated. Policy lending is being phased out and equitization is being stressed. In September 2007, the Prime Minister approved the equitization plan of Vietcombank, paying the way for an initial public offering (IPO) in the fourth quarter of 2007. It is proposed that 20% of total shares will be offered to international strategic investors. Among the remaining SOCBs, the Mekong Housing Bank is also scheduled for equitization within 2007, while Incombank and the Bank for Industrial Development of Vietnam plan IPOs in early 2008. The equitization process is expected to improve operational efficiency, risk management, corporate governance, and incentive structures in SOCBs.

18. **Future Actions.** The SBV has compiled a schedule of projects it wants to carry out. Its key tasks include the drafting and adoption of laws governing the State Bank of Vietnam, credit organizations, deposit insurance, and bank operation supervision and security. The revised SBV law and the law on credit organizations are scheduled to be submitted to the National Assembly for approval in 2008. An effort will be made to gradually improve the organization, functions, and operations of the banks that function under the SBV as a prelude to turning the SBV into a modern central bank.

2. Nonbank Financial Sector

19. The nonbank financial sector remains small, but its growth has been striking.

20. **Insurance.** The insurance industry in Viet Nam was established in 1994 and it experienced double-digit annual growth in premiums between 2002 and 2004, followed by 8.8% in 2005 and 9.9% in 2006. The Insurance Law, enacted in April 2001, allowed foreign joint venture insurance companies and wholly foreign-owned subsidiary branches to operate in Viet Nam. There are 28 enterprises conducting operations in life insurance, general insurance, re-insurance, and intermediary insurance, including two state-owned enterprise (SOEs), 11 joint stock companies, and 15 enterprises with foreign investment. In Viet Nam, unlike in most other developing countries, the life insurance market is larger than the markets for other forms of insurance. In 2006, the insurance industry wrote insurance premiums, net of reinsurance, amounting to D14.9 trillion (\$930 million), roughly 60% of which was life insurance and 40% general insurance. As a percentage of GDP, insurance premiums represented 1.72% in 2003, 1.73% in 2004, 1.62% in 2005, and 1.65% in 2006. The Government has placed great importance on total market growth. Strategy for Insurance Market Development (2003 – 2010)⁷ targets an increase in annual insurance premiums from 1.44% of GDP in 2002 to 4.2% by 2010.

21. State-owned insurance companies are still the dominant players in the general insurance market where they have a 74% market share. Their share of the life insurance market is 38%. The state-owned insurance firms Vietnam Insurance Corporation (Bao Viet) and Bao Minh, PetroVietnam Insurance (PVI) had IPOs targeting foreign strategic partners and international insurance companies in September 2007. Vietnam Reinsurance Corporation (Vinare) is in the process of identifying its foreign strategic partners. On the investment side, the insurance industry is limited in its range of options because of an underdeveloped capital market, limitations and uncertainties in the legal framework, and constrained asset management

⁷ Prime Ministerial Decision 175, " Approving the Strategy for the Development of Vietnam's Insurance Market from 2003 to 2010"

capacities within the industry. As a result, insurance industry investments are mainly in government bonds and bank deposits. However, the industry is actively seeking new investment opportunities to provide better maturity matches and higher yields.

22. Recognizing the challenges that Viet Nam's accession to WTO will pose, the Government's Insurance Market Development Strategy to 2010 has prioritized the need to restructure the legal and regulatory framework for the insurance industry in order to meet international standards and WTO requirements. Included among these proposed initiatives is a proposal to join the International Association of Insurance Supervisors. According to Viet Nam's WTO commitments, the Vietnamese insurance market will open completely as of 1 January 2008. After that, companies with foreign-investors will be allowed to offer compulsory insurance services in Viet Nam.

23. **Pensions.** In contrast to the insurance industry, the pension fund industry lags behind with one state-managed pension fund (the State Social Insurance Fund) for public servants. All employees working in the formal sector are required to participate in social insurance and pension schemes. However, in many cases, employers in the private sector do not pay their contributions and employees do not know their rights and benefits. The Social Insurance Law (SIL) was passed by the National Assembly on 29 June 2006 and it provides a legal foundation for the social insurance benefits to be provided by the Viet Nam Social Security (established to collect social security contributions, administer the Social Insurance Fund, and ensure timely payments of social security). The voluntary social insurance scheme for farmers was piloted in 2006 in advance of its implementation in January 2008.

24. **Leasing.** Financial leasing operations in Viet Nam are governed by Decree 16 (May 2001)—as amended by Decree 65 (June 2005). There are twelve finance leasing companies, three of which are joint ventures and five of which are subsidiaries of SOCBs. The activities of financial leasing companies are confined to (i) financial and operating leasing for machinery, equipment, vehicles, and other movable assets; (ii) advising clients on matters relating to financial leasing operations; and (iii) other services related to financial leasing. Preliminary market assessment indicates that the leasing market in Viet Nam grew at an annual rate of 50% over 2002–2004, before slowing down to an annual growth of 10% per annum during 2005–2006. Leased assets at the end of 2006 are estimated at about \$577 million. Leasing is still a new product in Viet Nam, and enforcement of its special security features still needs to be improved. The sector has not been able to meet the funding demands of the growing private sector because of limited funding sources, the small range of products offered, and low public awareness of leasing operations. While the leasing industry in Viet Nam is still at an early stage, the demand for medium-term financing (to which leasing is an attractive alternative, especially for smaller companies) is expected to grow. Leasing activities in Viet Nam are, however, constrained by their lack of access to long-term funds. Leasing companies that are subsidiaries of SOCBs currently source all or most of their funds from their respective banks. ADB is proposing a nonsovereign loan to Vietcombank Financial Leasing Company (VFLC), Vietcombank's leasing subsidiary, to fund term leases in response to demand from small and medium-sized enterprises (SMEs) in Viet Nam. Leasing companies' restricted access to the nascent corporate debt market has made them heavily dependent on their parent banks for short-term borrowings to fund medium-term leases. This has resulted in maturity mismatches in asset and liabilities and made it difficult for leasing companies to service SME demands for financial term lease.

25. **Accounting and Auditing.** In Viet Nam, an accounting and auditing system is being developed gradually, as part of the infrastructure for a sound and efficient financial sector. The

Accounting Law passed on 17 June 2003 (and Decrees 128 and 129 issued on 31 May 2004, providing guidelines on the Accounting Law) significantly modernizes accounting rules in line with international practices. The Government has yet to fully adopt an internationally-accepted accounting and auditing system that satisfies international standards. The general accepted accounting principles in Viet Nam are at an early stage of development and principles from the International Financial Reporting Standards (IFRS) are gradually being adopted. Listed companies do not necessarily comply with IFRS requirements. By the end of 2006, the Ministry of Finance (MOF) had issued 26 accounting standards and 37 statements on auditing, most of which were adapted from the International Statements on Auditing (ISA) with some modifications. Both local and foreign companies are required to comply with Vietnamese accounting standards.

26. The number of auditing firms has grown to 140. Of these, about a dozen are licensed by the MOF to provide services to listed companies based on meeting a set of threshold criteria, including minimum capital requirements, number of served clients, number of certified public accountant (CPAs), and number of years in operation. There are currently 900-1000 CPAs and this number is expected to increase by about 50% in the next 3 years. On 15 May 2007, Decision 32 on regulation on managing quality of auditing and accounting services was passed.

27. **Securities Market.** The stock market in Viet Nam has been growing at a phenomenal pace over the last 2 years with the VN index rising from 250 in mid-2005 to over 500 in June 2006 and 1100 in September 2007. There was a downward correction of 30% between May and September 2007, but the stock market recovered quickly in early October 2007, reflecting renewed investor interest, both domestic and international. The market has expanded rapidly with total market capitalization increasing to 33% of GDP in September 2007 as compared with 5% in mid-2005. The proposed equitization and listing of large SOEs, including state-owned commercial banks, telecommunication companies, and brewing companies would help increase the supply of quality securities and expand the size of the market. It is estimated the market for unlisted securities is three times larger than the formal market.

28. The capital market regulator is the State Securities Commission (SSC). It supervises Viet Nam's two exchanges: Hanoi securities trading center in Hanoi (HASTC) and the Ho Chi Minh City stock exchange (HOSE) and all licensed securities firms. By end of 2006, there were 55 licensed securities companies (an increase from 14 at the end of 2005) with an average chartered capital of about \$4.5 million. Of those 55 securities firms, 12 are wholly owned by commercial banks and one is owned by a state-owned insurance company. Securities registration, depository, clearing and settlement remain the function of the Securities Depository Center, which was separated from the HOSE in 2006. Cash settlement is done through the designated settlement bank (Bank of Development and Investment of Vietnam).

29. The HOSE started its operations with two former SOEs in July of 2000. By August 2007, it had 111 listed companies (market capitalization of \$12.1 billion), two securities investment funds (market capitalization of \$119 million) and 407 bonds. The HASTC opened in March 2005 and started operations in July 2005. By August 2007, it had 87 listed companies (market capitalization of \$4.8 billion) and 113 government bonds valued at about \$2,031 million had been traded on the floor. Since 1 July 2006, the Government has channeled auctions of government bonds exclusively through the HASTC and it plans to establish an exclusive bond trading platform. The intent is for the Hanoi floor to evolve into the over-the-counter (OTC) market for Viet Nam.

30. In early 2006, the MOF and the SSC approved Decision 898, a strategic development plan for capital markets toward 2010. Its main goal is to raise the level of operational and supervisory practices to international standards. The Securities Law, the drafting of which was supported by ADB TA, was approved by the National Assembly in July 2006 and became effective in January 2007 (footnote 3). The Securities Law incorporates International Organization of Securities Commissions (IOSCO) principles and aims to improve market transparency and corporate disclosure, strengthen market surveillance and supervision, and provide investor protection. Other relevant decrees and circulars issued include Decree 14 in January 2007 containing the implementing guidelines of the Securities Law; Decree 27 in April 2007 on the organization and operations of securities companies; Decree 35 in May 2007 on the organization and operation of fund management companies; Decree 36 in August 2007 on penalties for administrative offences in the securities and securities market sector; and Decree 38 in April 2007 on provisions on information disclosure for listed companies, public companies, securities firms, and investment fund management companies. It is expected that, if it is implemented properly, Decree 38 will bring more transparency to the market, especially for OTC transactions.

31. The SSC has prioritized a number of tasks and responsibilities and asked ADB for assistance in certain specified areas that would be consistent with the sector strategy being prepared for 2006–2010. The strategy includes: deepening and expanding the regulated trading markets, reducing the scope of the gray market and achieving a market capitalization of 10%–15% of GDP by 2010. This target was exceeded in 2007, when market capitalization exceeded 30% of GDP. The strategy also aims to strengthen the market supervision of both listed companies and unlisted public companies; enhance corporate governance standards; modernize the trading system and the market infrastructure, including the securities depository and settlement system; and develop a liquid bond market. It is envisaged that development of the bond market will be a core area under the proposed FSPL III. Coupled with the expected liberalization of the Vietnamese economy following Viet Nam's membership of WTO and the Government's target of equitizing 57 major state-owned corporations and groups between 2007 and 2010, the capital market in Viet Nam is expected to expand substantially.

32. **Housing Finance.** The housing finance industry is in its early stages. About 80% of housing finance credit (HFC) in Viet Nam comes from the informal sector. Less than 20% of HFC comes from the formal banking or Government sectors. Nevertheless, formal housing finance is increasing rapidly. Commercial retail banks providing housing loans to house owners represent about 10% of the total housing finance market. Most banks providing housing loans lack significant access to long-term credit funds, which they need to finance mortgage loans. Access to such funds is an important prerequisite for a strong housing finance market. Consequently, most housing loans originating from these institutions have a relatively short duration (no longer than 5 years) and are available only to medium- and higher-income groups. There is also a need for legal improvements to the mortgage system in Viet Nam. Once the primary mortgage market is well established, with a reasonable amount of mortgage receivables, developing a secondary market for mortgage-backed securities should be considered. A line of credit is available to SBV for on-lending to qualified financial institutions under an ADB loan⁸ for providing dwelling units to urban low-income groups and the poor.

33. On the supply side, there are clear signs of higher public demand for savings vehicles. Life insurance policies, with a heavy savings component, are growing dramatically, and there is

⁸ ADB. 2002. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Socialist Republic of Viet Nam for Housing Finance Project*. Manila.

an active gray secondary market for equitized SOE shares that have not been listed on the formal trading center. Both the demand and supply sides are growing in tandem with the robust economy, but the current financial system is not able to keep pace with the needs of the economy.

34. **Human and institutional capacities.** The skills required for market-based decision making and transactions are still largely lacking in Viet Nam and expertise in credit assessment, risk management, accounting and auditing, asset valuation, business planning, and marketing must be built over time.

35. The challenge for Viet Nam will be to (i) adopt measures that would speed up the process of building key institutions and human resources for the financial sector, and (ii) provide mechanisms that could meet the immediate funding needs of the economy without contradicting or interfering with the on-going work of building a market-based formal financial sector. More significantly, Viet Nam needs to improve the efficiency of the financial sector by intensifying structural reform efforts. In order to satisfy the increasing demand for capital in both the public and private sectors to support high economic growth, financial resources need to both grow and to be allocated more efficiently.

C. Government's Development Strategy

36. Since 1988, Viet Nam has adopted a wide range of reforms to transform its economy from a centrally planned to a market-based system. In the financial sector, much of the basic legal and institutional framework has been established. The reforms have led to a diversification of the financial system. Since the tentative opening of a securities market (for both fixed income and equity paper) in mid-2000, Viet Nam has seen the arrival of local securities companies and the first local fund managers and investment funds. Foreign fund managers have been present in Viet Nam since the early 1990s, mostly operating small private equity funds.

37. In Viet Nam, an accounting and auditing system is being developed gradually, as part of the fundamental infrastructure for a sound and efficient financial sector.

38. The Government expects insurance premium to reach 4.2% of GDP by 2010. The target for the annual average growth rate in revenue from insurance premiums is 20–30%. The Government plans to increase the charter capital of the insurance companies to improve their operational and financial capacity and to modernize their information technology infrastructure and thereby strengthen its risk assessment systems and procedures.

39. In leasing, efforts will continue to promote better interaction among different government ministries and leasing companies and to expand leasing in Viet Nam.

40. Viet Nam's WTO accession will inevitably expose Vietnamese economic actors to a highly competitive world. A stronger financial sector will encourage investors to invest more in Vietnamese industries. By introducing new processes and increasing the capacity of state and market institutions, the Government hopes to develop an effective financial sector that will protect the legitimate interests of all investors and can be integrated with international financial markets.

D. Asian Development Bank's Development Experience

41. ADB has supported the Government to introduce the basic concepts and systems of a market-based financial system and economy and to develop infrastructure and institutions through the first Financial Sector Program Loan⁹ and the State-owned Enterprise Reform Corporate Governance Program Loan.¹⁰ Outputs of these program loans include a credit information center, a secured transaction system, a deposit insurance corporation, accounting and auditing standards that are consistent with international accounting and auditing standards, a law on enterprise, a law on bankruptcy, and the introduction of best practices in corporate governance. The frameworks that have been created have been assessed to be sustainable. Under the ongoing Second Financial Sector Program Loan (footnote 2), ADB is supporting development of alternative channels of financial intermediation, insurance, leasing, money and capital markets. The goal is to develop the emerging nonbank sector so it can provide financial resources, particularly long-term funds and investment capital, to the growing private sector. In implementing policy reforms under FSPL II, the Government has shown strong commitment to carry the reform program forward. To sustain this momentum a Financial Sector Development Program Loan III is proposed for 2007. This will improve access to finance and provide a broader menu of financial services and tailored financial instruments, backed by an appropriate market infrastructure. Development of the social security system and the housing finance industry—two critical segments of the nonbank sector—are also being assisted by ADB. A social security law has been approved and housing loans are being provided to lower-income groups through housing finance intermediaries under the ADB Housing Finance Project (footnote 5).

42. To strengthen Viet Nam's anti-money-laundering regime, a decree on money laundering drafted with ADB TA support (footnote 4) was issued on 6 June 2005 and became effective on 1 August 2005. A follow-up TA project¹¹ is helping Viet Nam implement the decree. TA projects (footnote 3 and 4) have also been provided to strengthen the capacity of nonbank financial institutions and the market regulators.

43. ADB support aims to help the Government (i) develop physical infrastructure, (ii) improve the business-enabling environment through regulatory reforms, (iii) strengthen financial and related market institutions, and (iv) develop human resources.

44. The ADB country strategy and program (CSP) for Viet Nam highlights financial and corporate governance as a key sector in ADB's assistance program. In particular, ADB will work with the Government to strengthen the nonbank sector, which includes leasing, insurance, and securities markets, which have excellent growth potential.

III. PROGRAM IMPLEMENTATION

A. Status of Conditions for the Third Tranche

45. The Government has demonstrated its commitment to reform by taking actions in a number of key areas, in line with the objectives of FSPL II subprogram II. The Government's

⁹ ADB. 1996. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan and Technical Assistance Grant to the Socialist Republic of Viet Nam for Financial Sector Program*. Manila.

¹⁰ ADB. 1999. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Socialist Republic of Viet Nam for State-Owned Enterprise Reform and Corporate Governance*. Manila.

¹¹ ADB. 2005. *Technical Assistance to the Socialist Republic of Viet Nam for Support to Implement the Anti-Money Laundering Decree*. Manila.

successful compliance with all 15 conditions associated with the release of the third tranche under subprogram II is summarized below.

46. The status of compliance with third tranche conditions is detailed in Appendix 1. Appendix 2 provides some key measures undertaken by the Government and performance indicators related to the implementation of subprogram II.

B. Review of Progress in Implementation

1. Insurance Sector

47. Subprogram II supports the Government's efforts to enhance competition in the market, strengthen prudential regulations and market supervision, and further develop the market infrastructure.

a. Creating Equal Opportunities to Enhance the Competitiveness of the Insurance Market

48. The Government has made efforts to create equal opportunities and enhance the competitiveness of the insurance market through gradual liberalization under commitments made under a bilateral trade agreement of 2001 with the United States. Under the agreement, as of 12 October 2006, Viet Nam lifted all barriers against US insurance companies operating in Viet Nam. Similar provisions are also now binding under Vietnam's WTO commitments in the insurance field. American insurance companies, including Prudential, AIG, Manulife, New York Life, and Prevoir, now operate the life and non-life insurance businesses in Viet Nam, including branches. Prudential is currently the largest life insurance company in Viet Nam. The Government has made great changes to the insurance market of Viet Nam. State-owned insurance firms such as the Vietnam Insurance Corporation (Bao Viet), Bao Minh, and PetroVietnam Insurance (PVI) have had IPOs and sold shares to international insurance groups. According to Viet Nam's WTO commitments, the Vietnamese insurance market will open completely as of 1 January 2008. After that, companies with foreign investors will be allowed to supply compulsory insurance services in Viet Nam.

49. Decrees 42 and 43 have been replaced by Decrees 45 on implementing guidelines for the Insurance Law and 46 on financial regulations of insurance companies. These decrees deal in principle with all the practical aspects of operating insurance companies in Viet Nam, from license applications and conduct of the market to solvency and reserving.

50. **Condition (3-1)** of subprogram II requires the MOF to gradually phase out the compulsory reinsurance concession to the National Reinsurer of Viet Nam (Vinare). Decree 42 had required that 20% of the insurance premium be reinsured with Vinare. This requirement was removed under Decree 45 issued on 27 March 2007.

b. Enhancing corporate governance of insurance companies

51. The Regulator is committed to voluntary corporate governance principles, including risk management and the production of a corporate governance manual. Workshops targeting the directors and senior managers of Vietnamese insurance companies have been conducted, explaining the benefits of implementing corporate governance principles. These workshops have concentrated on such issues as the systemic identification of risks affecting insurance companies and managing them through risk management committees, the adoption of audit and

compliance committees, and the adoption of compliance manuals. The regulator has strongly supported initiatives to educate the insurance industry on corporate governance principles, resulting in high attendance rates by directors and managers of Vietnamese insurance companies at these workshops.

52. **Condition (3-2)** requires the MOF to recommend that insurance companies adopt compliance manuals and establish compliance committees, audit committees and risk management committees. It also requires them to hold seminars and workshops, and publish reference materials on the MOF website. Under an ADB TA project (footnote 3), several seminars and workshops were held by an ADB consultant with both the Ministry of Finance and industry from 2004 to 2006. The consultant drafted a report which provides details on “best practice” compliance regimes, including the establishment of compliance committees and a blueprint of a compliance manual. Materials on audit, risk management and compliance committees, and on compliance manuals are recommended and are now published on the MOF website (8 January 2007).

c. Strengthening supervision and prudential regulations

53. The introduction of prudential regulations in line with international standards is a critical step toward improving the regulatory framework for the insurance sector. The adoption of risk-based capital is part of such an exercise. Risk-based capital is a subset of corporate risk management, which is a process whereby the key risks facing an organization are identified and analyzed in terms of the probability of their occurrence and severance. They are then actively managed. Risk-based capital (RBC) represents an amount of capital based on an assessment of risks that a company should hold to protect customers against adverse developments. The amount of capital to be held is adjusted for the risks the company faces, including specific industry risks. RBC is a new regulatory concept to insurance market regulators in many developing economies and its adoption requires a process that depends on the level of market development.

54. **Condition (3-3)** requires the MOF to introduce RBC regulation for insurance companies. The ministry has sent staff for overseas training to enhance their understanding of the implementation of the risk-based regulatory system. ADB TA has funded presentations by consultants to the MOF and insurance companies. The key elements of RBC for insurance companies are the discounting and disallowing of assets and the weighting of liabilities. Both concepts are introduced within the present legal framework. Circular 99 makes reference to weighting of liabilities and disallowing of assets, and the new Decree 46 makes reference to discounting assets (Articles 14 and 17).

d. Developing Insurance Infrastructure

55. The expertise and effectiveness of the Insurance Department has improved considerably over the past 5 years. This has greatly benefited the industry, which is being supervised more effectively. The Regulator has adopted a transparent and consultative working environment, which encourages direct communication with the management of insurance companies, including foreign insurance operators. The Regulator has adopted an early warning system, enabling it to spot more effectively when an insurance company’s financial position has deteriorated. Recently adopted regulations require companies to adopt reserving techniques more in line with international standards (e.g., an open claims file methodology for general insurers), and a sign-off of the annual accounts by senior management, actuaries and auditors.

Staff training is now undertaken in systematic fashion, with new staff working alongside senior staff for the first 2 years, so that they receive on-the-job training.

56. The MOF established a finance and insurance department offering undergraduate and graduate degrees at the Academy of Finance in 2004. About 150 full-time students have graduated from the department. The Vietnam Insurance Association also runs training courses for staff of the insurance companies. Training of regulators and improving the capacity of the Insurance Supervision Market are priorities in the Strategy for Insurance Market Development (2003 – 2010, footnote 7).

57. **Condition (3-4)** requires at least 50% of the staff at the insurance supervision department of the Ministry of Finance's to have completed insurance-related courses at recognized institutions, including the Academy of Finance. Over 90% of the staff in the department have degrees related to insurance and over 50% of staff are presently undertaking further insurance-related studies. Six members of staff are studying overseas, including one actuarial student in France. A list of training courses undertaken by department staff has been provided to ADB.

2. Leasing Sector

a. Establishing a regulatory environment conducive to business development and clear ground rules for contract enforcement

58. The leasing industry remains a small but growing part of the financial sector. The legal framework governing leasing was improved with the issuance of Decree 65, replacing Decree 16. Decree 65 allows leasing companies to offer financial and operating leases and buy-back and lease-back options. The new decree also enables the mobilization of alternative funding sources such as syndicated leasing and sale of receivables in addition to such traditional sources as bank loans and bonds. However, one of the constraints to the leasing business is the protection of the right of the lessor in case of a default by the lessee and this is what condition (3-5) is designed to address.

59. **Condition (3-5)** requires SBV and the Ministry of Justice (MOJ) to cooperate with related ministries and to issue a circular detailing procedures and methods to deal with leased assets in cases where a lessee violates the lease contract. After Decree 16 had been issued, SBV established a working group with representatives from SBV, MOJ, and the Ministry of Public Services (MOP) to draft the above circular. Comments received from the leasing companies and ADB have now been incorporated into an inter-ministerial regulation on lease asset foreclosure that was signed by both SBV and MOJ in November 2007.

b. Organizing Activities for Public Awareness and Capacity Building

60. There is a need to enhance public awareness of the benefits of the leasing business. This is particularly the case for SMEs that need to tap alternative funding sources to meet their medium-term capital investment requirements. ADB TA supported seminars organized by SBV to increase public awareness on the benefits of leasing (footnote 3). FSPL II also supported the establishment of the Vietnam Leasing Association in 2006.

61. **Condition (3-6)** requires SBV to encourage the leasing industry association to: (i) form a committee for public awareness activities, and (ii) establish a small and medium-sized enterprise (SME) assistance center and training program. The charter of the Vietnam Leasing

Association requires the association to undertake training programs and a Decision by the Association has been issued for establishing the committee for public awareness and training. The leasing association coordinates with SBV in conducting seminars and workshops to improve public awareness of leasing products and operations, mainly targeting SMEs. Two such workshops were conducted in June 2007 in Ho Chi Minh City and in August 2007 in Hanoi. The committee for public awareness activities will become active when the leasing association has sufficient members.

3. Interbank and Money Markets

a. Developing money market instruments

62. The money market in Viet Nam is at an early stage of development with banks more inclined to deal with the central bank (SBV) than with one another. There are no official statistics of the volume of money market transactions although most transactions are in form of inter-bank deposits. The lack of diversity in money market instruments is also a constraining factor in the development of the money market. Although regulations on certificates of deposit were drafted, the instrument has not been developed. A standard repurchase agreement was prepared by SBV in coordination with the Vietnam Bankers Association.

63. **Condition (3-7)** requires the submission of a draft negotiable instruments law to the National Assembly (**compliance has been exceeded**). With the support of ADB TA (footnote 1), the Negotiable Instruments Law was drafted, incorporating key principles of the International Convention on the Bills of Exchange. The National Assembly approved the law in December 2005 and guidelines for its implementation were issued in July 2006. The law and its guidelines laid the legal groundwork for the issuance and trading of the bills of exchange and promissory notes. ADB also supported SBV to conduct two seminars, one each in Ho Chi Minh City and Hanoi, to disseminate the objective and contents of the Negotiable Instruments Law.

b. Improving market microstructure

64. **Condition (3-8)** requires SBV to develop the interbank market by introducing money brokerages. Regulation 351 issued in April 2004 allowed credit institutions to carry out money brokerage activities. However, given the low level of money market transactions, there has been no interest in setting up separate money brokerage business and all activities are currently carried out by the individual treasury units within each credit institution. In order to facilitate the development of the repurchase market, SBV advised the Bankers Association in 2004 to develop a master repurchase agreement for use across all market intermediaries. A permanent advisor has now been engaged under a Japan International Cooperation Agency (JICA) project to advise SBV on monetary policy issues, including on money markets. SBV plans a strategy for the development of the interbank market for 2008 to 2015. As a result, a survey was recently carried out in August 2007, supported by JICA, to identify mechanisms to develop the repurchase market, prepare a code of ethics for repurchase transactions, draft measures to improve bond auctions, improve the interbank market, set up criteria for interbank deposits, and prepare measures to improve transparency and coordination between policy makers and the market. It is expected that the strategy will be formalized and issued in 2009.

c. Enhancing state-owned commercial banks' treasury function and capacity

65. SOCBs account for about 70% of total banking deposits and greatly influence the level of liquidity in the market. According to SBV, SOCBs are the most active participants in T-bill auctions and open market operations. Money market activities in Viet Nam will depend on the efficiency of the treasury operation within SOCBs. Reorganization of these treasury operations and deployment of the core banking system has enabled SOCBs to overcome the limitations related to liquidity forecasting and management. SBV also require the liquidity position of individual banks to be reported to them daily so they can forecast market liquidity. This is a key tool for SBV's monetary policy operations.

66. **Condition (3-9)** requires SBV to issue regulations that require all state-owned commercial banks to (i) identify and report, daily, their liquidity position, and (ii) limit the number of nostro accounts¹² to a manageable level. Decision 01 issued by SBV on 5 January 2007 requires all banks who are members of SBV's open market operations to report every day on their liquidity positions.¹³ Circular 7477 of July 2007 prescribes detailed procedures for daily reporting, which is applicable to all SOCBs. SBV's IT system has been upgraded and is being tested. In the meantime, all SOCBs now manually report their respective liquidity positions to SBV every day.

67. With regard to limiting the number of nostro accounts to a manageable level, Notification 78 dated 21 January 2003 specifies that banks are allowed to conduct international transactions and are licensed to open overseas bank accounts. They must report details of all such transactions to SBV within 15 days of the opening any such new account and submit quarterly statements with details of all transactions in these accounts to SBV. By this process, SBV is able to monitor balances of such overseas accounts. SBV is also in a position to monitor the daily foreign exchange positions of commercial banks to limit any speculation or any excess foreign exchange position that may result in a foreign exchange currency shortage. The Foreign Exchange Ordinance and Decree 160 dated 28 December 2006 on Foreign Exchange Management require commercial banks to strengthen their internal audit systems and thus enable commercial banks to manage their nostro accounts more efficiently.

4. Capital Markets

68. Subprogram II of FSPL II supports the improvement of the regulatory framework and capital market structure.

a. Establishing consolidated regulatory framework

69. Prior to 2006, the securities market operation was governed by Decree 144, which covered only listed securities.

70. **Condition (3-10)** requires the SSC to draft and the MOF to submit a draft securities and exchange law to the Government which includes: (i) corporate disclosure requirements; and (ii) supervisory, investigation, surveillance and enforcement mechanisms (**compliance has been**

¹² A banking term to describe an account one bank holds with a bank in a foreign country, usually in the currency of that foreign country, which is used to carry out transactions that are denominated in that foreign currency.

¹³ Decision 477, earlier issued on 28 April 2004, requires all banks undertaking interbank transactions to report their overall liquidity positions every day.

exceeded). The Securities Law that was approved in July 2006 and became effective in January 2007 includes such provisions. The law broadens the scope of market supervision to cover securities of unlisted public companies. It is estimated that the unlisted securities market is three times larger than the two stock trading centers. The securities law incorporates IOSCO principles on market surveillance and supervision and adheres to international commitments on market liberalization under the WTO.

b. Enhancing market microstructure

71. The capital market infrastructure—including the trading platform, central depository, registration, and clearance and settlement systems—has evolved over time. International organizations such as the IOSCO and Bank for International Settlement Systems now recommend a set of standard practices to reduce the risks embedded in securities transactions. To capitalize on the experiences of developed markets, such standard practices need to be considered in structuring the market architecture of the small but growing securities market in Viet Nam. An appropriate market structure and trading system will help improve trading efficiency, reduce transaction costs, and facilitate investor protection. The trading systems at Hanoi and Ho Chi Minh City use a continuous order matching system. However, a negotiated dealer trading system has been adopted to allow large transaction at the Ho Chi Minh City Exchange. Manual order entries by brokers are being replaced by electronic order entries.

72. **Condition (3-11)** requires the SSC to introduce an index-based circuit breaker system in the design of the automated trading system of the stock exchange. This circuit breaker would suspend trading if market volatility exceeds a certain limit. The SSC and the STC have been working to modernize the trading system and to include a circuit breaker system. ISC Consulting Services in Hong Kong, China, in coordination with Ho Chi Minh City Stock Trading Center, has developed bidding documents for procurement of a composite IT system that includes a proposal for an index-based circuit breaker system.

5. Financial Market Infrastructure (Accounting and Auditing)

Strengthening a self-regulatory organization (SRO) function in the accounting enforcement system

73. This component of FSPL II seeks to (i) establish the accounting enforcement mechanisms, and (ii) develop a competitive accounting industry.

74. The MOF has prepared a strategy to 2010 for the accounting profession, with a section on the Vietnamese Accounting Association (VAA). The VAA held a General Assembly in 2004 to elect a new president, approve new charter, and approve a 5-year action plan. With support from ADB TA (footnote 3), a self-regulatory organization (SRO) plan was drafted. In addition, the Viet Nam Association of Certified Public Accountants (VACPA) was established under the umbrella of VAA in April 2005. VAA has nine member associates including VACPA and 14 members of staff. The VACPA has about 400 primary members who are CPAs working for 61 accounting and auditing firms in Viet Nam, its own website, and three members of staff in Hanoi and two in Ho Chi Minh City.

75. **Condition (3-12)** requires the MOF to draft a legal document (a decision) enabling VAA to assume responsibilities as an SRO and to submit this to the Government for issuance. The MOF issued Decision 47 on 14 July 2005 and this specifically provides for the gradual transfer of SRO functions to VAA and VACPA.

76. **Condition (3-13)** requires the MOF and the VAA to begin implementation of the plan for the VAA to assume responsibilities as an SRO. The VAA and VACPA have preformed reasonably well during the past 18 months. The major responsibilities now delegated to VACPA include (i) conducting training for accountants and auditors, (ii) managing the accountants licensed by MOF, (iii) publishing the list of certified accountants and if they fall below expectations and reporting this to the MOF, and (iv) supporting the MOF to conduct examinations for accountants.

6. Deposit Insurance System

77. A system of credit cooperatives was established in Viet Nam in the mid-1990s. After a period of development and consolidation, the People's Credit Funds (PCFs) network includes two types of institutions. PCFs represent the cooperative network (there are 933 PCFs in 53 provinces) and the CCF is a cooperative bank (with 24 branches). PCFs provide loan and deposit services to the rural population. The shareholders of PCFs are also depositors and borrowers. Depositors at PCFs are protected by Deposit Insurance of Vietnam (DIV) in line with Decrees 109 and 89 on deposit insurance. DIV has so far settled the claims of 1,353 depositors of 32 failed PCFs for a total of D14,067 billion. Sixty PCFs have had their business licenses invoked by SBV because of weaknesses in their lending operations and noncompliance with prudential regulations. According to their by-laws, each PCF is self-governing, self-operating, and self-reliant. The PCF network means that financial risk is spread over more than 900 units. However, it also means that the image and financial stability all PCFs can be affected by the insolvency of just one member. The safety of the PCF network can be improved by linking the PCFs that have safety funds. SBV piloted a safety fund for PCFs in Thai Binh Province and this has been expanded to An Giang and Hung Yen Provinces.

78. **Condition (3-14)** requires the Government to approve a funded system for depositors' protection in PCFs. With assistance from ADB TA in the last quarter of 2006 (footnote 1), a draft plan for establishing a safety fund was developed and finalized by mid- August 2007 and circulated for comments within SBV. A seminar was held on 7 September 2007 to invite public comments on the plan. The Deputy Governor of SBV approved the plan to establish a safety fund on 30 September 2007. The plan specifies the organizational and governance structure of the fund and its intervention policies. The size of the premium to be levied by the fund is being determined.

7. Establishing an Anti-Money-Laundering System

79. Subprogram II of FSPL II includes measures to support (i) establishment of the legal and regulatory basis for combating money laundering, and (ii) developing an anti-money-laundering system for reporting suspicious transactions. The draft decree was originally prepared with assistance provided under ADB TA (footnote 3). Decree 74 creates the legal framework for anti-money-laundering and was signed by the Prime Minister on 6 June 2005 and took effect on 1 August 2005. An essential element of any anti-money-laundering system is an anti-money-laundering information center to receive and analyze financial intelligence. Subprogram II also supported SBV to issue anti-money-laundering guidelines under which commercial banks are required to set up a know-your-customer (KYC) procedure, to report any large or suspicious transactions, and to appoint an anti-money-laundering compliance officer. Viet Nam is now a member of the Asia-Pacific anti-money-laundering group as part of the commitments made under FSPL II.

80. **Condition (3-15)** requires the Government to (i) establish an anti-money-laundering information center with adequate staffing and internal procedures, and (ii) ensure there is a functioning compliance program. The anti-money-laundering information center (AMLIC) has 13 members of staff including the director. The Deputy Governor of SBV has approved a total staff of 21 within 2007, with some to be recruited from the market and the remainder to be assigned from the supervision department of SBV.

81. With support from an ADB consultant (footnote 12), AMLIC has drafted internal procedures that include its organizational structure, its personnel, mandate, and the terms of reference for each division. These internal procedures were issued under Decision 49 on 27 September 2007. AMLIC also issued directives on 30 June 2006 for all credit institutions to adopt the compliance procedures as detailed under Document 281 of 30 June 2006 with a requirement for all credit institutions to fulfill the detailed requirements by end September 2007. AMLIC chose 10 credit institutions for further evaluation and assessed all 10 were implementing the prescribed internal compliance programs. Condition (3-15) is therefore considered to have been satisfactorily complied with.

82. There has been some delay in establishing an information technology system within AMLIC. The United Nations Office on Drugs and Crime (UNODC) has agreed to help install the IT system, with the software to be provided free. A feasibility study has been completed and a timetable for implementation and installation of the IT system has been developed. The invitation to bid is scheduled for April 2008 with procurement and installation by the fourth quarter of 2008.

IV. CONCLUSIONS

83. The Government has made significant progress in implementing reforms and enhancing financial sector intermediation under subprogram II of FSPL II. The relevant agencies' commitment to implement subprogram II was clearly evident throughout the implementation period and justifies the release of the third tranche of \$10 million.

V. THE PRESIDENT'S DECISION

84. In view of the solid progress made in the implementation of Subprogram II of the Financial Sector Program Loan II (FSPL II), as evidenced by the full compliance with all 15 third tranche release conditions, the President is satisfied with the overall implementation of the FSPL II, and that the necessary conditions for the release of the third tranche of FSPL II – Subprogram II have now been fulfilled. In accordance with the established procedure, the President will authorize the release of the third tranche in the amount of Special Drawing Rights 6,791,000 equivalent under FSPL II - Subprogram II. The authorization shall be effective not less than 10 working days after the circulation of this progress report to ADB's Board of Directors.

STATUS OF THIRD TRANCHE CONDITIONS

A. INSURANCE SECTOR

Development Objective	Subprogram II	Current Status (details of actions taken stated under paras. 45-82 in the main text)
Creating equal opportunities to enhance the competitiveness of the insurance market.	(3-1) Ministry of Finance (MOF) to gradually phase out the compulsory reinsurance concession to the National Reinsurer of Viet Nam.	Complied with.
Enhancing corporate governance of insurance companies.	(3-2) MOF to recommend that insurance companies adopt compliance manuals and establish compliance committees, audit committees and risk management committees, including holding seminars and workshops, and publishing reference materials on the MOF website.	Complied with.
Strengthening supervision and prudential regulations.	(3-3) The insurance supervisory body under MOF to introduce risk-based capital regulation for insurance companies.	Complied with.
Developing insurance infrastructure.	(3-4) At least 50% of MOF insurance department staff to have completed insurance-related courses at recognized institutions, including the Finance Institute.	Complied with.

B. THE LEASING SECTOR

Development Objective	Subprogram II	Current Status (details of actions taken stated under paras. 45-82 in the main text)
Establishing regulatory environment conducive to business development and clear ground rules for contract enforcement.	(3-5) SBV, MOJ, to cooperate with related ministries and issue a circular detailing procedures and methods to deal with leased assets in cases where a lessee violates lease contract.	Complied with.

Organizing activities for public awareness and capacity building activities.	(3-6) SBV to encourage the leasing industry association to: (i) form a committee for public awareness activities, and (ii) establish a small- and medium-sized enterprise (SME) assistance center and training program.	Complied with.
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B. INTERBANK/MONEY MARKETS

Development Objective	Subprogram II Third Tranche Conditions	Current Status (details of actions taken stated under paras. 45-82 of the main text)
Developing money market instruments.	(3-7) The Government to submit a negotiable instruments law to the National Assembly.	Exceeded Compliance.
Improving market microstructure.	(3-8) SBV to develop the interbank market by introducing money brokerages.	Complied with.
Enhancing state-owned commercial banks' treasury function and capacity.	(3-9) SBV to issue a regulation with provisions that require all state-owned commercial banks to (i) identify and report, daily, their liquidity position; and (ii) limit the number of nostro accounts to a manageable level.	Complied with.

C. CAPITAL MARKETS

Development Objective	Subprogram II Third Tranche Conditions	Current Status (details of actions taken stated under paras. 45-82 of the main text)
Establishing consolidated regulatory framework.	(3-10) SSC to draft and MOF to submit a draft securities and exchange law to the Government which includes: (i) corporate disclosure requirements; and (ii) supervisory, investigation, surveillance and enforcement mechanisms.	Exceeded Compliance.
Enhancing market microstructure.	(3-11) SSC to introduce an index-based circuit breaker system in the design of the automated trading system of the stock exchange.	Complied with.

D. FINANCIAL MARKET INFRASTRUCTURE

1. Accounting and Auditing System

Development Objective	Subprogram II	Current Status (details of actions taken stated under paras. 45-82 of the main text)
	Third Tranche Conditions	
Strengthening an SRO function in the accounting enforcement system.	(3-12) MOF to draft, and submit to the Government for issuance, a legal document (a decision) enabling VAA to assume responsibilities as an SRO.	Complied with.
	(3-13) MOF and VAA to begin implementation of the plan for VAA to assume responsibilities as an SRO.	Complied with.

2. Deposit Insurance System

Development Objective	Subprogram II	Current Status (details of actions taken stated under paras. 44-81 of the main text)
	Third Tranche Conditions	
	(3-14) The Government to approve a funded system for protecting depositors in people's credit funds.	Complied with.

3. Anti-Money-Laundering

Development Objective	Subprogram II	Current Status (details of actions taken stated under paras. 45-82 of the main text)
	Third Tranche Conditions	
Establishing an anti-money laundering system.	(3-15) The Government to (i) operationalize the financial intelligence unit with: (a) adequate staffing; and (b) functional internal procedures; and (ii) ensure there is a functioning compliance program.	Complied with.

MOF = Ministry of Finance, MOJ = Ministry of Justice, SBV = State Bank of Viet Nam, SME = small and medium-sized enterprise, SRO = self-regulatory organization, SSC = State Securities Commission, VAA = Vietnamese Accounting Association.

KEY GOVERNMENT MEASURES AND PERFORMANCE INDICATORS

Key Government Measures

- Viet Nam signed United Nations Convention on Anticorruption in 2003
- Viet Nam joined the Asian Development Bank—Organization for Economic Co-operation and Development Initiative for Anticorruption in Asia and Pacific in July 2004
- A Competition Law passed in December 2004 which prohibits firms with market shares in excess of 50% to conduct mergers. It also outlaws cartels and pyramid structures
- Law on the Prevention and Combating of Corruption passed in November 2005 and effective in July 2006
- Unified Enterprise Law passed by the National Assembly in November 2005 and became effective in July 2006
- Government issued Decree No 139 on 5 September 2007 to clear some of the obstacles encountered by enterprises seeking to establish businesses in Viet Nam.
- New Investment Law passed in 2005 to establish the same conditions for foreign and domestic businesses, and for private companies and SOEs. The law encourages private sector participation in various forms
- Decree No. 109 dated 26 June 2007 on conversion of enterprises with 100% state-owned capital into shareholding companies

FSPL II Subprogram II Program

Impact

Develop a financial system with better financial intermediation, efficiency, and accessibility

Outcome

Develop alternative channels of market-based financial intermediation

Outputs

1. Support economic policies conducive to sound and vibrant development of the nonbanking subsector
2. Establish legal and regulatory frameworks that will promote innovation and healthy competition while at the same time monitoring and reducing systemic risks

Insurance

- The new Insurance Law, enacted in April 2001, allowed foreign joint venture insurance companies and wholly foreign-owned subsidiary branches to operate in Viet Nam. There are 28 insurance enterprises conducting operations in life insurance, general insurance, re-insurance, and intermediary insurance. These consist of two state-owned enterprises, 11 joint stock companies, and 15 companies with foreign investment. In Viet Nam, unlike in most other developing countries, the life insurance market is larger than the general insurance market
- On 1 August 2001, the Government issued Decree 43. Article 18 of the decree provides regulations covering financial issues of insurers and brokers and states the steps to deal with the situation where companies are experiencing solvency problems
- The time for product approval for most general insurance products has been shortened from 7 days to 3 days
- Circular 98 of 19 October 2004 stipulates that all life insurers need to have approved actuaries on staff
- Circular 99, issued on 19 October 2004, requires sign-off by an auditor acceptable to Ministry of Finance
- Decision 153 on a System of Monitoring Indicators, which was adopted and came into effect in

- March 2003, relates to an early warning system for both life and general insurance companies
- Under Decision 27 on the Finance Institute a banking and insurance department was established in 2002
- Decision 23 on motor liability insurance was issued in February 2003, including minimum terms and conditions
- The Prime Minister's Decision 175 in August 2003 on insurance market development strategy includes a direction to develop the capacity of the insurance supervisory department
- Detailed guidelines for implementation of the Insurance Law were issued under Government Decree 42 dated August 1 2001 and Ministry of Finance Circular 71 dated August 28 2001. Regulations on the financial regime for insurance business were issued under Government Decree 43 dated August 1 2001 and Ministry of Finance Circular 72 dated August 28. Decrees 42 and 43 have now been replaced by Decrees 45 of March 2007 on implementing guidelines for the Insurance Law and 46 of 27 March 2007 on financial regulations of insurance companies
- The key elements of Risk Based Capital for insurance companies namely the discounting and disallowing of assets and the weighting of liabilities are now covered under Decree 46, Articles 14 and 17
- Compulsory reinsurance to National Reinsurer of Viet Nam (Vinare) removed under Decree 45
- Materials on audit, risk management and compliance committees, and on compliance manuals now published on the MOF website since January 2007

Leasing

- Decree 16 of May 2001, which allowed leasing companies to engage in activities other than financial leasing
- Article 1.28 of Decree 16 outlines procedures for the enforcement of leasing contracts
- On 19 May 2005, the Government issued Circular 4 providing some amendments and supplements to Decree 16 which states that all contracts on financial leasing must be registered at the NSART
- The Ministry of Justice subsequently issued Circular 9 on 6 December 2005 This provides guidance on implementation of: (i) authority, tasks and powers of the registration agency in registration and provision of information on finance-leasing contracts, (ii) order and procedures for registration of and provision of information on finance-leasing contracts
- Ministry of Home Affairs issued Decision 1004 dated 10 July 2006 approving the establishment of the Vietnam Leasing Association
- SBV Circular 07 and Circular 08 issued in September and October 2006 respectively, providing the legal base for syndicated leasing and sale and lease back operations.
- The Ministry of Justice issued Circular 4 of May 2007 revising the procedures for registration of, and supply of information on asset leasing contracts and, financial leasing contracts

Interbank Money Markets

- The Negotiable Instruments Law was approved on December 2005 and became effective in July 2006

Capital Markets

- The action plan on securities market development 2006–2010 was approved by the Prime Minister in August 2003
- The Hanoi Stock Trading Center (STC) opened on 5 March 2005
- The Law on Securities and Securities Market was approved by the National Assembly in June 2006
- Code of conduct for securities dealers and brokers issued in November 2006
- Decree 36 on administrative penalties was issued in March 2007
- Decree 14 on implementation guidelines for securities law was issued in March 2007
- Decision 17 in information disclosure was issued in April 2007
- Decision 27 of 24 April 2007 contained regulations on the organization and operations of securities companies
- Decision 35 of 15 May 2007 contained regulations on the organization and operations of fund

management companies

- Circular 38 was issued on 18 April 2007 covering disclosure of information on the securities markets
- Over 200 listed companies on Ho Chi Minh City and Hanoi STCs, with market capitalization accounting for 31% of GDP as of 30 September 2007
- 15 investment funds in operation. Over 50 securities companies licensed. 100,000 trading accounts as of 30 September 2007 compared to 31,000 trading accounts in 2006

Financial Market Infrastructure

Accounting

- The Accounting Law passed on 17 June 2003 and Decrees 128 and 129 issued on 31 May 2004, providing guidelines on the Accounting Law, significantly modernize the use of accounting standards and bring it in line with international practices
- The Ministry of Finance had issued 26 accounting standards and 33 statements on auditing as of the end of May 2005
- Decision 47 was issued in July 7, 2005, transferring certain oversight responsibilities over CPAs and CAs to VAA and VACPA
- Circular 72 was issued on 28 June 2007 by the Ministry of Finance stipulating in detail the principles and procedures of registration and management of accounting practice as they apply to individuals and companies that register to provide accounting services

Secured Transaction System

- The National Registry Agency for Secured Transactions (NRAST) was established and operated in 2002. NRAST opened branches in Ho Chi Minh City and Da Nang in 2003.
- Government issued Decree 63 on secured transactions in January 2007
- NRAST prepares for online secured transaction registration

Deposit Insurance

- Decree 109 of August 2005 when read with Article 6 of Decree 89 of September 1999 allows DIV to charge differential premiums based on certain implementation guidelines
- Decree 109 is an amendment of Article 19 of Decree 89 that allows DIV to mobilize capital by (i) receiving loans or special support capital from the Government, (ii) issuing bonds according to the provisions of the law on the issuance of bonds, and (iii) obtaining loans from credit institutions or other organizations with Government guarantees
- Article 14 of Decree 89 and the amendment of Article 15 of Decree 89 with item 6 of Decree 109 provides strict conditions for extending financial support to problem banks

Anti-Money Laundering

- An anti-money-laundering Decree 74 was issued on 6 June 2005
- An anti-money-laundering information center was established under SBV to record and monitor large and suspicious transactions in June 2006
- Viet Nam joined the Asia Pacific Group on anti-money-laundering in 2007

CA = Certified Accountant, CPA = certified public accountant, DIV = Deposit Insurance of Vietnam, FIU = Financial Intelligence Unit, MOJ = Ministry of Justice, NA = National Assembly, NRAST = National Registry Agency for Secured Transactions, SBV = State Bank of Viet Nam, STC = Stock Trading Center, UN = United Nations, UEL = Unified Enterprise Law, VAA = Vietnam Accounting Association, VACPA = Vietnam Association of Certified Public Accountants.

Performance Indicators

Design Summary	Targets/Measurable Indicators	2000	2001	2003	2005	2006
Develop a financial system with better financial intermediation, efficiency, and accessibility	Gross domestic product (GDP) growth (%)		6.9	7.3	8.4	8.2
	Increased money supply (M2)/GDP (%)	50		71	79	92
	Increased domestic savings and foreign direct investment (%)	20 (1995)	26.2	27.1	32	
	Investment to GDP ratio(%)		32.1	33.9	37.6	37
	Share of private sector in total investment (%)		23	27	32	37
	Share of SOE to total investment (%)		60	54	52	46
	Bank credit to private sector (%)		58	65	68	68
	Interest rate deregulation in August 2002, which enables banks in principle to price their loans based on credit risk			deregulated	deregulated	deregulated
Develop alternative channels of market-based financial intermediation	Total securities listing value (D trillion)	1.5	3.4	13	45.2	410
	Total securities listing (growth rate in %)		125	147	39.8	811
	Total listing value (% of GDP)	3.0	3.6	2.2	5.3	41%
	Listed companies	5	11	22	51	200
	Equity market capitalization (D trillion)	—	2.3	3.8	7.3	300
	Equity market capitalization (% of GDP)	—	—	0.4	0.5	31
	Listed bonds (number of issues)	4	18	103	281	466
	Listing bonds (par value D trillion)	1.2	2.9	11.7	33.9	109
	Listing bonds value (% of GDP)	0.3	0.6	2.0	3.5	12%
	Insurance: revenue from premiums (D trillion)	—	—	10.4	15.6	17.7
	Insurance: Revenue from premiums (% of GDP)	—	—	1.7	1.8	1.8
	No. of leasing companies				9	9
	Total leased assets (D trillion)			7.2 (2004)	8.9	9.2

— = not available.