



Progress Report on Tranche Release

Program Number: 30295
Loan Number: 2118
November 2006

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

CURRENCY EQUIVALENTS

(as of 24 November 2006)

Currency Unit	–	dong (D)
D1.00	=	\$0.000062
\$1.00	=	D16,082

ABBREVIATIONS

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
AFD	–	Agence Française de Développement
AML	–	anti-money laundering
DAF	–	Development Assistance Fund
DIV	–	Deposit Insurance of Viet Nam
FSPL	–	Financial Sector Program Loan
GDP	–	gross domestic product
IAS	–	International Accounting Standards
IMF	–	International Monetary Fund
MOF	–	Ministry of Finance
MOJ	–	Ministry of Justice
NBFS	–	nonbank financial sector
NI	–	negotiable instrument
NPL	–	nonperforming loan
PCF	–	people's credit fund
PRC	–	People's Republic of China
SBV	–	State Bank of Viet Nam
SERD	–	Southeast Asia Department
SOCB	–	state-owned commercial bank
SOE	–	state-owned enterprise
SSC	–	State Securities Commission
SRO	–	self-regulatory organization
STC	–	securities trading centers
TA	–	technical assistance
VAA	–	Vietnamese Accounting Association
VACPA	–	Viet Nam Association of Certified Public Accountants
VASB	–	Viet Nam Association of Securities Brokers
WTO	–	World Trade Organization

NOTE

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

Vice President	C. Lawrence Greenwood, Jr., Operations Group 2
Director General	R. Nag, Southeast Asia Department (SERD)
Director	J. Ahmed, Governance, Finance, and Trade Division, SERD
Team leader	V. Subramanian, Senior Financial/Private Sector Development Specialist, SERD
Team members	N. T. Bui, Financial Sector Officer, SERD R. O'Sullivan, Senior Counsel, Office of the General Counsel

CONTENTS

	Page
I. INTRODUCTION	1
II. MACROECONOMIC AND FINANCIAL SECTOR ISSUES AND DEVELOPMENTS	2
A. Macroeconomic Development	2
B. Financial Sector	4
C. Government's Development Strategy	8
D. Asian Development Bank's Development Experience	9
III. PROGRAM IMPLEMENTATION	10
A. Status of Policy Actions for Second Tranche	10
B. Review of Progress in Implementation	10
C. Status of Policy Actions for Third Tranche	16
IV. CONCLUSIONS	17
V. THE PRESIDENT'S DECISION	17
APPENDIXES	
1. Policy Matrix	18
2. Key Government Measures and Performance Indicators	25

I. INTRODUCTION

1. Viet Nam's financial sector mirrors its economy and is in transition. The Government has made persistent efforts to modernize and transform the financial sector, recognizing its significance to the country's economic performance. Financial intermediation is low and dominated by bank savings and loans. In June 2001, the Government initiated the process of financial and operational restructuring of the banking subsector with assistance from the International Monetary Fund (IMF) and World Bank under the poverty reduction and growth facility and poverty reduction support credit. The Financial Sector Program Loan II (FSPL II) was formulated to complement this process. It specifically 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. The Asian Development Bank (ADB) Board of Directors approved the cluster approach for FSPL II comprising Subprogram I for \$50 million from the Asian Development Fund (ADF) on 20 November 2002 and Subprogram II for \$35 million on 3 December 2004. FSPL II is further supported by cofinancing from Agence Française de Développement (AFD) for €35 million, including €23 million for Subprogram I and €12 million for Subprogram II, to be disbursed in tranches on the same schedule and with the same conditions as the ADB disbursements. The proceeds are to be used to finance the costs of projects directly linked to reforms in the financial sector.

3. FSPL II Subprogram II, building on the achievements of Subprogram I, aims to support the Government's effort 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 nonbank financial subsector (NBFS) and the capital market is critical to providing the long-term funds and investment capital that are largely lacking in Viet Nam. Higher efficiency is expected to be achieved through increased competition from the NBFS. This process will make the whole financial system broader, better balanced, and more resilient against external shocks. Necessary components include (i) economic policies conducive to sound and vibrant financial sector development; (ii) legal and regulatory frameworks that promote innovation and healthy competition while monitoring and reducing systemic risks; (iii) regulators with the authority, budgets, skills, and established procedures to monitor and enforce regulations; and (iv) supporting financial infrastructure.

4. FSPL II Subprogram II was approved on 3 December 2004 and declared effective on 15 March 2005. Subprogram II is to be released in three tranches: (i) \$10 million equivalent from ADF upon compliance with the first tranche release conditions, (ii) \$15 million equivalent from ADF subject to fulfillment of second tranche release conditions, and (iii) \$10 million equivalent from ADF subject to completion of third tranche release conditions. The first tranche of \$10 million was released on 20 December 2005. Completion of policy actions for the second tranche was expected by end September 2006 followed by the third tranche by end March 2007. The release of the second tranche has now been extended to 31 December 2006, as the Government has requested an additional 3 months for accomplishing all second tranche release conditions.

5. ADB technical assistance (TA) 4290¹ supported the Government in undertaking some of the policy conditions proposed under Subprogram II of FSPL II.

¹ ADB. 2004: *Technical Assistance to the Socialist Republic of Viet Nam for Capacity Building for the Financial Sector and Capital Markets*. Manila.

6. The implementation of the second tranche policy actions under Subprogram II was reviewed in detail in May 2005, March 2006, and September 2006. An overview of the compliance status of all 15 second tranche program conditions is in Appendix 1, justifying the release of the second tranche of \$15 million.

II. MACROECONOMIC AND FINANCIAL SECTOR ISSUES AND DEVELOPMENTS

A. Macroeconomic Development

7. Since 1988, Viet Nam has adopted a wide range of reforms in an effort to transform its economy from a centrally planned system to a market-based one. Viet Nam has one of the fastest-growing economies in Asia, averaging gross domestic product (GPD) annual growth of 7.5% over the last decade, fuelled by robust expansion in domestic demand, rapid growth in private investment and strong export performance. GDP growth was 8.1% in 2005 and 7.4% in the first half of 2006, forecast at 7.8% for the whole year. Viet Nam's economic growth exceeds that of all other countries in the Asia and Pacific region except the People's Republic of China (PRC), while the country also records unprecedented reductions in poverty, sustained macroeconomic development, and continued improvement in key human development indicators such as education, health, and life expectancy. Economic reform has clearly accelerated since the beginning of the current planning cycle (2001–2006). Several mechanisms currently at play, from integration with the world economy to decentralization, are bound to accelerate the reform process even more. Vietnam accession to the World Trade Organization (WTO) approved on 7 November 2006 will have far-reaching implications, from lower trade barriers for goods to competition in services and the adoption of an array of laws and regulations. The preparation of the 5-year Socioeconomic Development Plan 2006–2010 is also providing an opportunity to articulate the future reform agenda across sectors and provinces. Private enterprise already plays a significant role in the economy, generating over 40% of GDP and employing 30% of the workforce. However, the growth of most private enterprises continues to be constrained by limited (i) access to financing, (ii) recognition of land titles, and (iii) availability of financial information.

8. The fiscal deficit has remained well under 5.0% of GDP in recent years (2.3% in 2005, excluding net lending). External debt comprises around 33% of GDP. This low level of debt, combined with its highly concessional nature, implies that Viet Nam faces a low risk of external debt stress. Foreign exchange reserves more than doubled in the past 3 years, to \$7.7 billion in 2005.

9. The national savings rate in Viet Nam is increasing steadily from less than 20% in 1995 to 32% in 2005. The investment-GDP ratio has been rising, reaching a high 37.6% in 2005. This is the second highest rate in the Asia and Pacific region, after that of the PRC. The investment-GDP ratio is estimated at around 40% over 2006–2010. While Viet Nam's savings ratio is also high, capital efficiency must be increased to sustain high growth. Despite recent marginal improvements, capital productivity remains low (as reflected in an incremental capital output ratio of 4.8:1). Hence, the above ambitious investment target stresses the need for strenuous efforts to strengthen the financial mechanism to help generate domestic resources, improve investment decision making, and increase transparency to manage and prioritize limited resources.

10. Some key structural changes have taken place in the economy of Viet Nam over the last decade. First, there is a substantial shift in the economic structure. Agricultural output occupied over 30% of GDP in 1990s but only 20% in 2005, while the share of industry increased to 41% and that of services to 38%. Industry and services occupy a growing share of the economy with industry (rising by an estimated 9.3%) and services (7.7%) driving growth in the first half of 2006. This reflects market-oriented reforms and a gradual reduction in barriers to competition and private sector development. The domestic private sector expanded its share of overall investment from 23% in 2001 to 34.5% in the first half of 2006.

11. Viet Nam will soon become the 150th member of the WTO (its accession to WTO was approved on 7th November 2006). To meet the consequent challenges of a more liberalized environment, a much bolder approach to reforming the banking sector has finally been adopted, and a new approach to reforming state-owned enterprises (SOEs) is emerging.

12. The number of SOEs has declined steadily from 5,600 in 2001 to around 3,000 at the end of 2005, guided by master plans for each line ministry and province approved by the Prime Minister. From an initially slow start, transformations picked up in the second half of 2003 and throughout 2004. The reduction in SOEs has been mainly through equitization, whereby the SOE, after a sale of shares, is converted to a joint stock company that operates under the Enterprise Law, rather than under the SOE Law. Other forms of SOE transformation have been mergers, conversions to limited liability companies, outright sales, and liquidation. Initially, the focus of equitization had been on smaller SOEs, but in 2004 the list of sectors where 100% state ownership is to be retained was substantially shortened. Since then, the average size of the transformed SOEs has been rising. To promote SOE reform, the State Capital Investment Corporation has been set up to manage the Government's stakes in equitized SOEs. However, progress on equitizing the larger SOEs has been slow, and the Government has requested ADB assistance in the equitization process of SOEs, including both general corporations and state-owned commercial banks (SOCBs).

13. For 6 consecutive years since the promulgation of the Enterprise Law in 2000, the number of newly registered local enterprises has increased dramatically. The accumulated number of enterprises registered under the Enterprise Law from 2000 to 2005 is over 158,000, with committed capital of D311 trillion (over \$19 billion). In its effort to further improve the business environment, the National Assembly passed the Unified Enterprise Law and Common Investment Law in December 2005. Improvements in the business environment, coupled with the continuation of economic growth and the prospects of joining the WTO, have increased investor confidence, such that more than 20,000 new enterprises were established in the first half of 2006 and foreign direct investment commitments rose by 21% to \$2.3 billion.

14. The Government increasingly recognizes the pivotal role that the private sector has played in economic development and job creation. Preliminary estimates indicate that the private sector generated almost 90% of the 7.5 million jobs created during the 5 years to 2005, of which 64% were generated by small enterprises employing fewer than five people. Most of the 1.6 million new jobs Viet Nam needs to create annually in 2006–2010 are expected to be generated by the private sector. The Government and ADB need to focus on facilitating increased private sector investment and developing the market institutions needed to promote competitiveness and create jobs.

15. Viet Nam already has high ratios of investment and resource mobilization to GDP. The challenge is to use these resources more efficiently to increase capital productivity. The planned increase in the share of the private sector in total investment will be critical to improving capital

productivity. The domestic private sector in particular has generated much higher output and employment per unit of investment than either the state sector or foreign investment.

16. The investment-GDP ratio is estimated at around 40% over 2006–2010 (about \$140 billion). The share of the state in total investment is expected to decline from 51.1% in 2001–2005) to 44.6%, with a marked decline in the share of state credits. The share of the private sector is expected to increase from 49.0% to 55.4%, with a sharp increase in the share of domestic private investment from 29.8% to 34.4%.

Financing the Socioeconomic Development Plan
(D'000 billion in 2005 prices)

Item	2001–2005 estimates		2006–2010 Plan		Ratio (2006–2010/ 2001–2005/)
	Total	Structure (%)	Total	Structure (%)	
1. State Budget	307.2	22.9	445.4	20.2	1.4
2. State Credit	170.3	12.7	205.4	9.3	1.2
3. SOE Investment	207.8	15.5	333.2	15.1	1.6
4. Domestic Private Investment	399.8	29.8	758.9	34.4	1.9
5. Foreign Direct Investment	223.5	16.6	377.8	17.1	1.7
6. Others	35.2	2.6	83.5	3.8	2.4
Total	1,343.8	100	2,204.2	100	2.4
Of which					
State	685.3	51.0	984.0	44.6	1.4
Non-State	658.5	49.0	1220.2	55.4	3.3

SOE = state-owned enterprise.

Note: Columns may not add up because of rounding.

Sources: Socio-Economic Development Plan (2006–2010), ADB Country Strategy and Program 2006–2010.

B. Financial Sector

1. Banking Sector

17. The banking sector continues to expand rapidly. Net domestic assets increased at an annual rate of 32% in 2005. Local currency deposit increased by over 30% in the same period. Bank credit extended to the private sector increased by nearly 68% in 2005, following a 65% increase in 2004 and 58% in 2001. Viet Nam's economy is increasingly monetizing. The ratio of M2 to GDP, which measures the level of financial deepening, increased from 50% in 2000 to 75% in 2004 and almost 79% in 2005. The average interest rate spread ranges from 4% to 4.5%. The banking sector has been playing an important role in supporting the country's high economic growth as well as rapid development of the formal economic sectors. However, continued reform of the sector to address nonperforming loans (NPLs) and operational inefficiency is required to ensure its sound and sustainable growth.

18. Progress in all areas of banking reform has been significant, especially in the last 2 years. In 2001, the banking reform program aimed to restructure joint stock banks and make them comply with regulatory standards. As for SOCBs, it involved phasing out their policy lending, resolving their existing NPLs, subjecting them to International Accounting Standards (IAS) audits, and re-capitalization. The pace of reform in all these areas has picked up after an initially slow start. The share of credit to the private sector rose to 68% in 2005 from 58% in 2001.

19. SOCBs' compliance with banking regulations, though improved since 2001, still falls short of requirements. Regulations for prudential ratios and asset classification have been strengthened and are to be complied with in a phased manner over the next 3 years. However, a fairly accurate estimate of NPLs has not been publicly disclosed. The recent World Bank study estimates NPLs much higher when IAS are applied. As a prelude to WTO membership, Viet Nam is initiating further measures to strengthen the banking system. In May 2006, the Government issued a plan for banking sector reform under which the supervisory functions of the State Bank of Viet Nam (SBV) will be separated from the management functions that it performs for SOCBs. Equitization of the SOCBs is proceeding and will help market participants obtain a better picture of their worth. Vietcombank and Mekong Housing Bank are in the final stages of hiring external consultants to value the banks, while the Bank for Investment and Development of Vietnam issued a fixed-rate long-term bond to increase its tier II capital. Late in 2005, Vietcombank issued convertible bonds to raise tier II capital ahead of the equitization plan. However, the strategy to resolve NPLs and recapitalize SOCBs has been delayed.

2. Nonbank Financial Sector

20. The NBFS remains small, but its growth has been quite noteworthy.

21. **Insurance.** The insurance industry in Viet Nam has experienced remarkable growth in the past few years. 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 insurance enterprises conducting operations in life insurance, other forms of insurance, re-insurance, and intermediary insurance, including two SOEs, 11 joint stock companies, and 15 foreign-invested enterprises. In Viet Nam, unlike in most other developing countries, the life insurance market is larger than the market for other forms. The gross premium grew by 48% in 2003 and 19% in 2004. Viet Nam's insurance penetration rate as a percentage of GDP stood at 1.72% in 2003 and 1.73% in 2004. Total revenue in 2005 was D15.6 trillion, making the penetration rate equivalent to 2.03% of GDP. 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.

22. **Pensions.** In contrast to the insurance industry, the pension fund industry lags, with only 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 a social insurance and pension scheme. However, in many cases, employers in the private sector do not pay their contributions, and employees do not know their rights and benefits under the scheme. This presumably slows the development of the capital markets and the private sector alike by discouraging workers' migration from the public sector to the private. The voluntary social insurance scheme for farmers was piloted in 2006 in preparation for its implementation in January 2008.

23. **Leasing.** Leasing remains a small but growing segment in the financial sector, with leased assets amounting to D7.2 trillion in 2004 and D8.9 trillion in 2005, with a growth rate of over 23% in 2005. There are currently nine leasing companies, six of which are Vietnamese and three of which are foreign invested. The sector has not been able to meet the funding demand of the growing private sector. This can be ascribed to an inadequate regulatory framework. Subprogram II of the FSPL II continues to support the Government's efforts to improve the legal framework for registering leased contracts and assets and foreclosure procedures, to diversify the range of leasing products offered, and to enhance public awareness of leasing operations.

24. **Accounting and Auditing.** An accounting and auditing system is gradually being developed as part of the fundamental infrastructure for building a sound and efficient financial sector in Viet Nam. The Accounting Law, passed on 17 June 2003, and Decrees 128 and 129, issued on 31 May 2004, provide guidelines on the Accounting Law and significantly modernize accounting in line with international practices. The need exists to further strengthen accounting standards and the quality of auditing in Viet Nam. The Government has yet to fully adopt accounting and auditing systems that meet international standards. General accepted accounting principles in the country are at an early stage of development, gradually adopting principles from the International Financial Reporting Standard, with which listed companies do not necessarily comply. Meanwhile, the Ministry of Finance (MOF) had issued 26 accounting standards and 33 statements on auditing as of the end of May 2005, most of which were adapted from the International Statements on Auditing with some modifications. Local and foreign companies alike are required to comply with the Vietnamese Accounting Standards.

25. **Securities Market.** The action plan on securities market development 2006–2010 was approved by the Prime Minister in August 2003. The Securities Law, whose drafting was supported by ADB TA 4035², was approved in July 2006 and will become effective in January 2007. In addition, the Government and MOF will promulgate decrees for implementing the law. The securities market experienced phenomenal growth, with the VN Index rising from 250 in mid-2005 to surpass 500 in June 2006. The size of the market increased rapidly, with market capitalization of both listed equity and bonds accounting for nearly 10% of GDP in June 2006, compared with about 5% in mid 2005. Currently, 53 companies are listed in the Ho Chi Minh City and Hanoi securities trading centers (STCs), against 28 companies listed in 2005.

26. Fifteen securities companies now operate in Viet Nam with a total registered capital of D1,391 billion. They are scattered in Hanoi, Ho Chi Minh City, Hai Phong, and Binh Duong, with trading representative offices located in many major provinces and cities. In addition, the country's eight fund management companies include two fund managers founded by foreign life insurance companies, two joint-venture fund managers, one fund manager under the Vietnam General Corporation of Insurance, and one private fund management company. At 53, the number of listed enterprises remains modest in comparison to the number of joint stock companies and the total number of enterprises in Viet Nam. Securities registration, depository, clearing, and settlement remain the functions of the Securities Depository Center. Cash settlement is done through a designated settlement bank, the Bank for Investment and Development of Viet Nam. The trading cycle of T+3 is applied to stocks and T+2 to bonds. The Vietnam Stock Index has surged 66% in 2006 in dollar terms. There are now 1,043 foreign investors, including institutional and individual investors, in the securities market in Viet Nam, but they must hold less than 49% of outstanding shares of an issuer.

27. Though the State Securities Commission (SSC) is still under MOF, it enjoys a certain independent status in regulating and supervising the securities market. MOF is more involved in the policy side and in issuing legal documents related to the securities market. Securities trading centers are under the management of SSC. Once the Securities Law becomes effective in 2007, the trading centers will graduate to the stock exchange model. The SOEs financing needs are still more dependent on credit channels from banks as mobilizing resources from the securities market is relatively limited, more so with SOEs prevailing low level of information disclosure and corporate governance standards.

² ADB. 2002. *Technical Assistance to the Socialist Republic of Viet Nam for Capacity Building for Nonbank Financial Institutions and the Capital Market*. Manila.

28. Despite the recent growth of the organized market, it remains small. State holdings of equity in listed companies account for roughly 30%, stifling trading and liquidity in the secondary markets. No corporate bonds have yet been issued by any enterprise via the securities markets. The trading platforms at the STCs operate with old technology, offering limited capacity for expansion of trading functions, surveillance, and information disclosure. Far more active than the regulated stock market is the unregulated one, on which the shares of many unlisted joint stock companies are traded. The stock trading volume of the unregulated market is estimated to be three to six times than that of the Ho Chi Minh City STC, where trading averaged approximately \$0.3 million equivalent in May 2005. Further, the government securities market and primary market, both of which are inactive, impede the development of Viet Nam's capital market.

29. With a view to achieving the strategic goal of developing a safe and efficient securities market for mobilizing domestic and foreign capital flows for economic and social development, SSC has prioritized a number of tasks and responsibilities and requested ADB assistance in certain areas that would be consistent with the sector strategy under preparation for the period 2006–2010. The strategy for securities market development 2006–2010, as approved by the Prime Minister, includes (i) deepening and expanding the regulated trading markets; (ii) reducing the scope of the gray market; (iii) achieving market capitalization of 10%–15% of GDP by 2010, (iv) establishing international corporate governance standards in listed companies, with all securities issued by public companies to be registered and deposited with the Securities Depository Center; (v) preparing conditions for upgrading the Hanoi Stock Trading Center as an over-the-counter market with lower requirements for listing; (vi) developing hedge instruments; (vii) modernizing the securities trading system and related technology infrastructure at STCs and stock exchanges; (viii) assuming the rights and duties of an International Organization of Securities Commissions (IOSCO) member and implementing principles of securities market regulation in line with recommendations of IOSCO; and (ix) signing bilateral memoranda of understanding with regional exchanges. ADB proposes to help SSC in developing a plan for international integration of the Vietnamese securities industry.

30. **Housing Finance.** The housing finance industry is very much in the nascent stage. About 80% of housing finance credit in Viet Nam comes from the informal sector, and less than 20% from the formal banking or Government sectors. Though still underdeveloped, formal housing finance is growing rapidly. Commercial retail banks occupy about 10% of the total housing finance market. Most banks giving housing loans lack significant access to long-term credit, which is much needed to finance mortgage loans and an important prerequisite for developing a strong housing finance market. Consequently, most housing loans originating from these institutions have a relatively short duration of no longer than 5 years and are available only to middle- and higher-income groups. The mortgage system in Viet Nam needs legal improvements. Once the primary mortgage market is well established with a reasonable mass of mortgage receivables, the means and modality for 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 ADB Loan 1990³ to provide dwellings to low-income and poor urban residents.

³ 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 the Housing Finance Project (Summary Procedure)*. Manila (Loan 1990-VIE, approved on 20 December, for \$30 million).

31. On the fund supply side, there are clear signals from the public of higher demand for saving vehicles. Life insurance policies with heavy savings components are growing dramatically, and there is an active gray secondary market for equitized SOE shares that have not been listed on the formal trading center. Although both the demand for and the supply of funds are growing in tandem with the robust economy, the current financial system is unable to keep pace with the needs of the economy.

32. **Human and Institutional Capacities.** The skills required for market-based decision making and transactions are still largely lacking in Viet Nam. The skills for credit assessment, risk management, accounting and auditing, asset valuation, business planning, and marketing that are essential for the economy to function on a market basis must be built over time.

33. 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 and would not contradict or interfere with the ongoing work of building a formal market-based financial sector. More significantly, Viet Nam needs to improve the efficiency of the financial sector by intensifying its structural reform efforts. To satisfy the increasing demand for capital in both the public and private sector to support high economic growth, financial resources need to be both expanded and allocated more efficiently.

C. Government's Development Strategy

34. Since 1988, Viet Nam has adopted a wide range of reforms in an effort to transform its economy from a centrally planned system to a market-based one. In the financial sector, much of the basic legal and institutional framework has been established. Reforms have led to diversification of the financial system. To develop the securities market, SSC was established on 28 November 1996. Since the 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 relatively small private equity funds.

35. In May 2003, the Prime Minister signed Decision No. 163 on approving a strategy for securities market development up to 2010. The decision presents a vision and principles, specific targets, and solutions. The main objective is to develop a securities market in line with the direction of national socioeconomic development and international standards and practices to allow Viet Nam to gradually integrate into the regional and world financial markets. It also aims to integrate and develop the systematic structure of the financial market within the country and link the development of the securities market with the development of the money, capital, and insurance markets. The aim is to extend the size and scope of the centralized securities market to reach a total market capitalization of 10–15% of GDP by 2010. This would require the securities markets to attract investment funds equal to 38% of GDP.

36. The Government expects insurance penetration to reach 4.2% of GDP by 2010. An average annual growth rate in revenue from insurance premiums is targeted at 20-30%. The Government plans to increase the charter capital of the insurance companies to improve their operational and financial capability and modernize its information technology infrastructure to strengthen its risk assessment systems and procedures.

37. In leasing, efforts will continue to promote better interaction among the different government ministries and the leasing companies to expand the market.

38. WTO accession will inevitably expose Vietnamese economic actors directly to a highly competitive world. An improved financial sector will encourage investors to invest more in Vietnamese industries. The Government strategy is to develop a coherent and conducive environment for the whole financial sector. By introducing new processes and increasing the capacities of various state and market institutions, the Government hopes to develop an effective financial sector that protects the legitimate interests of all investors and readily integrates with international financial markets. The ultimate objective is to have an improved financial sector that will encourage investors to invest more in Vietnamese industries. The attendant reduction of financial costs and bolstered robustness of financial systems will make Vietnamese industries resilient against international competition and shocks.

D. Asian Development Bank's Development Experience

39. ADB supported the Government's efforts to introduce and adopt basic concepts and systems integral to a market-based financial system and economy and develop infrastructure and institutions through the first Financial Sector Program Loan⁴ and the State-Owned Enterprise Reform and Corporate Governance Program Loan.⁵ Program-backed outputs include the credit information center; secured transaction system; deposit insurance corporation; accounting and auditing standards consistent with International Accounting and Auditing Standards; laws on enterprise and bankruptcy; and the introduction of best practices in corporate governance. While the effective functioning of the financial system will continue to require capacity-building support, the new frameworks are assessed to be sustainable. Under the ongoing FSPL II,⁶ ADB supports the development of alternative channels of financial intermediation, insurance, leasing, money, and capital markets. The goal is to develop the nascent NBFS to 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 carrying the reform program forward. This momentum needs to continue in order to develop a diversified financial system for Viet Nam so that the country's broad-based economic growth and socioeconomic development objectives, including poverty reduction, can be achieved. To sustain this momentum the Financial Sector Development Program Loan III is proposed for 2007 to improve access to finance and provide a broader menu of financial services and tailored financial instruments backed by appropriate market infrastructure, and so develop a more competitive, stable, and broad-based financial system. The development of the social security system and housing finance industry—two critical segments of the NBFS sector—are also being assisted by ADB. A draft social security law has been developed, and housing loans are being provided to lower income borrowers through housing finance intermediaries under the ADB Housing Finance Project (see footnote 3). Further assistance will be examined based on the outcomes of these two projects.

⁴ 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 the Financial Sector Program Loan* (approved on 19 November 1996, for \$90 million). Manila.

⁵ ADB. 1999. *Report and Recommendation of the President to the Board of Directors on Proposed Loans and Technical Assistance Grants to the Socialist Republic of Viet Nam for the State-Owned Enterprise Reform and Corporate Governance Program*. Manila (approved on 21 December 1999, for \$100 million).

⁶ ADB. 2002. *Report and Recommendation of the President to the Board of Directors on Program Loan Cluster to the Socialist Republic of Viet Nam for the Second Financial Sector Program* (approved on 20 November 2002, for \$75 million). Manila.

40. To strengthen Viet Nam's anti-money laundering (AML) regime, a decree on money laundering, drafted with TA provided as part of the ADB TA 4035⁷, was issued on 6 June 2005 and became effective on 1 August 2005. Follow-up TA 4731⁸ has been approved to help Viet Nam implement the decree. TA has also been provided for strengthening the capacity of the NBFS and market regulators.

41. ADB support aims to help the Government develop the foundations for increased private sector investment and employment, including assistance to (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. ADB plans to directly help improve the business-enabling environment through regulatory, SOE, and governance reforms, and so develop financial and related market institutions.

42. The country strategy and program for Viet Nam highlights financial and corporate governance as a strategic sector for ADB assistance and critical for sustaining Viet Nam's economic growth. Development of the NBFS and, in particular, the capital market, will be critical to mobilizing resources from the market and providing the long-term funds and investment capital largely lacking in Viet Nam. Developing these subsectors will increase competition in the financial sector and thus pressure financial institutions—banks in particular—to improve their efficiency.

III. PROGRAM IMPLEMENTATION

A. Status of Policy Actions for Second Tranche

43. The Government has demonstrated its commitment to reform by taking the required actions in a number of key areas, in line with the objectives of FSPL II Subprogram II. The Government's successful implementation of all 15 policy actions associated with the release of the second tranche under Subprogram II is summarized below.

44. The status of implementation under the second tranche conditions is presented in more detail in Appendix 1. Based on the design and monitoring framework, 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

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

45. Condition 2-1 requires MOF to issue minimum terms and conditions of insurance for each class of compulsory insurance. Technically, no new laws (decrees, circulars or otherwise) were enacted during the program period to introduce additional compulsory insurance categories and therefore it was not necessary for MOF to issue any minimum terms and conditions. To further reforms in the insurance sector, MOF has now submitted a draft decree

⁷ ADB. 2002. *Technical Assistance to the Socialist Republic of Viet Nam for Capacity Building for Nonbank Financial Institutions and the Capital Market*. Manila.

⁸ ADB. 2005. *Technical Assistance to the Socialist Republic of Viet Nam for Support to Implement the Anti-Money Laundering Decree*. Manila.

on traveler insurance, with minimum terms and conditions of insurance for this category expected to be issued within 3-6 months of the decree being issued. Currently only third party insurance (personal and property) is compulsorily required under MOF Decision 23 of 2003 on Motor Liability Insurance, including minimum terms and conditions. (Status: fully complied)

b. Strengthening Supervision and Prudential Regulations .

46. Condition 2-2 requires MOF's insurance department to submit a capacity-building plan to MOF including human resource and training programs. The aim is to effectively exercise state management functions over insurance business through planning, policy formulation, prudential principles, supervision, and implementation. The Prime Minister's Decision 175 in August 2003 on an insurance market development strategy includes a direction to develop the capacity of the insurance supervisory department. Apart from ongoing training activities for staff, the Insurance Supervision Department finalized and adopted its action plan for capacity building developed under ADB TA 4290 (see footnote 1). Eight new staff positions were created in March 2005, bringing the staff number to 23. For the short term, a European Union grant has made an international actuary available within MOF. Meanwhile, an MOF staff member is undertaking a full-time actuarial course in France (2005–2008), after which the staffer will be contracted to work for MOF for a minimum of 3 years. Training programs have been developed to 2010 in addition to the various international training courses and seminars attended by MOF staff during 2005 and 2006. (Status: fully complied)

47. Condition 2-3 requires MOF to have introduced regulations that require signing off reserves in the annual accounts of insurance companies by an MOF-appointed actuary. MOF Circular 98, dated October 2004, includes the legal obligation of signing off by an appointed actuary. Seven actuaries are currently approved by MOF. Life insurance companies, including the fully government-owned one, have access to, or employ on a full-time basis, competent, qualified actuaries. All actuaries are well qualified. Circular 98 applies only to life insurance companies, not to other forms of insurance, for which statisticians, rather than actuaries, are needed. Very few non-life insurance companies in developing economies have qualified actuaries, and such companies in Viet Nam would have difficulty affording actuarial services. (Status: fully complied)

c. Developing Insurance Infrastructure

48. Condition 2-4 requires MOF to support the Association of Vietnamese Insurers' adoption of a code of conduct for insurance brokers and agents. MOF has endorsed codes of conduct for insurance companies. For non-life insurance, codes of conduct on fair insurance and on chief owner liabilities have been adopted. For life insurance, codes of conduct for agent recruitment have been adopted. MOF also established a forum for all life insurance companies to improve codes of conduct. This condition has been met insofar as MOF supports such a code of conduct. Each insurance company has its own separate code of conduct. As MOF is of the opinion that it cannot impose a uniform code of conduct for all, its preference is that the industry regulate itself in this respect, while MOF has tended to focus on discouraging such practices as undercutting premiums. Codes of conduct tend to be similar in most insurance companies, and there are subcommittees that address specific areas such as maritime, fire, etc., and each subcommittee makes a determination of how to calculate fair premiums in their industry. Nonspecific sanctions are often imposed on erring insurance agents. Each agent must represent a single company, with multiple agents not allowed. As companies are responsible, agents cannot be regulated, but any agent found to operate in an unethical manner by the insurance company is removed

and put on a black list so that he or she cannot be hired by another company (Circulars 98 and 99). The code of conduct is also a topic in training materials and formal examinations.

49. The Association of Vietnamese Insurers has organized training courses for adopting the required code of conduct. In addition, the association has contributed to establishing a comprehensive database that includes details on casualty insurance agents, life insurance agents and brokers, as well as a record of their misconduct and violations. This database is accessible to all insurance companies for the purpose of cross-checking the performance and record of agents and brokers. MOF has forwarded a letter to the insurance association together with the draft of the uniform code of conduct for all brokers recommending its adoption. (Status: fully complied)

2. Leasing Sector

a. Establishing a Regulatory Environment Conducive to Business Development and Clear Ground Rules for Contract Enforcement

50. Condition 2-5 requires SBV to revise Decree 16 to (i) allow leasing companies to provide both finance and operating leasing and (ii) stipulate procedures and methods to deal with leased assets in cases where a lessee violates lease contract. Leasing companies in Viet Nam were earlier allowed to provide only financial leasing services as per provisions under Decree 16. The Enterprise Law of 2000 resulted in increased demand for equipment and other fixed asset leases from private small and medium-sized enterprises, resulting in the regulation being issued on 15 June 2004 to allow the provision for operation lease services. This was further strengthened through SBV Circular 07, issued in September 2006, and Circular 08, issued the following month, providing the legal bases for syndicated leasing and sale and lease back operations. Foreclosure of lease assets in case of default is normally a problem in developing economies including Viet Nam. Article 1.28 of revised Decree 16, issued in June 2005, outlines procedures for the enforcement of leasing contracts. Essentially, lessors have the right to take possession of leased assets in the event of contract violation without having to take the lessee to court. It also limits the ability of the lessee to delay the process. The lessor, however, is required to dispose of the recovered asset within 60 days and must return any excess funds recovered to the lessee. The lessee remains liable for any shortfall. (Status: fully complied)

b. Organizing Activities for Public Awareness and Capacity Building

51. Condition 2-6 requires SBV to have supported the establishment of, and subsequently recognized, a leasing industry association established by leasing companies. In July 2006, the Ministry of Home Affairs issued Decision 1004, which approves the establishment of the Viet Nam Leasing Association. Members of the association include all leasing companies and corporate clients, thereby facilitating a more sustainable institutional mechanism for policy advocacy and awareness enhancement. TA 4290 (see footnote 1) supported SBV's organization of a seminar on leasing operations in Hanoi and Ho Chi Minh in 2004, as well as in November 2006. Participants in the seminars included regulators, representatives from all leasing companies, and corporate clients. The purpose of the seminar was to disseminate legal and regulatory documents on leasing activities, as well as to educate participants on, and enhance public awareness of, leasing operations. (Status: fully complied)

3. Interbank and Money Markets

a. Developing Money Market Instruments

52. Though condition 2-7 required only the submission of the draft Negotiable Instrument (NI) Law (drafted with the support of TA 4290) to the National Assembly, with its approval slated as a third tranche release condition, the NI Law was approved in December 2005, and the guidelines for its implementation were issued in July 2006. TA 4290 also supported SBV's conducting of two seminars, one each in Ho Chi Minh City and Hanoi, to enhance public awareness of the NI Law. (Status: fully complied)

4. Capital Markets

a. Broadening the Capital Market Base

53. Condition 2-8 requires amendment of Decree 64 to provide incentives, including tax measures, for equitizing SOEs to list on the stock exchange. The MOF Document 11924 TC/CST of October 2004 and 5248/TC-CST of 29 April 2005 reduces corporate income tax by half for the first 2 years of listing and exempts newly-established fund management companies and securities companies from tax for the first 3 years of operation and reduces its corporate income tax by half for the next 2 years. In addition, the MOF has established a steering board to provide incentives for companies to list in the stock exchange. The number of companies listed increased from 20 in 2004 to 53 in September 2006 while market capitalization increased from 3% to over 7% of GDP during the same period. Decree 187/2004/ND-CP on SOE equitization issued in 2004 replaces Decree 64/2002/ND-CP of 2002 requiring SOEs under equitization with a public offering of 10% of equity capital or above to auction their shares on the stock market rather than via securities firms. Article 36 of the above Decree provides incentives for equitization of SOEs. In April 2005, Decision 528 was issued on 14 June 2005 which requires 250 SOEs to be equitized and listed and also requires MOF to provide guidance on tax incentives for SOEs listing in the local trading centers. Further, the Law on Securities and Securities Market has enhanced the disclosure requirements for unlisted companies, thereby reducing the gap in disclosure requirement between listed and unlisted companies. (Status: fully complied)

b. Developing a Self-Regulatory Organization (SRO)

54. Condition 2-9 requires SSC to support an association of securities dealers and brokers (or a securities industry association) as an SRO to issue a code of conduct for securities dealers and brokers. SSC has concluded a cooperation and assistance agreement with the Viet Nam Association of Securities Brokers (VASB) and supported preparing the code of conduct by providing reference documents. This outline or framework served as a reference document for VASB and securities companies for drafting the detailed code of conduct, which was eventually issued on 22 November 2006. Supporting VASB's issuance of the code of conduct and monitoring of compliance is the initial step toward VASB assuming SRO status. (Status: fully complied)

5. Financial Market Infrastructure

a. Accounting and Auditing

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

i. Strengthening the SRO Function in the Accounting Enforcement System

56. Condition 2-10 requires MOF to have strengthened the Vietnamese Accounting Association (VAA) and, working with VAA, to have developed a plan for VAA to assume responsibilities as an SRO. MOF has prepared a strategy to 2010 for developing the accounting profession, under which a section has been devoted to VAA. VAA, which now has a staff of 14, held a general assembly in 2004 to elect a new president and approve a new charter and 5-year action plan. Qualifications of members were raised. With support from ADB TA 4290 (see footnote 1), an 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. VACPA has about 400 primary members, who are certified public accountants working for 61 accounting and auditing firms in Viet Nam. VACPA has three staffers in Hanoi, two staffers in Ho Chi Minh City, and its own website.

57. MOF issued Decision 47 on 7 July 2005, which transfers certain oversight responsibilities over certified public accountants and certified auditors to VAA and VACPA. From 2006, responsibility for accounting issues will fall under VAA, while auditing issues will fall under VACPA. Training programs for examinations and to provide updates on new accounting policies will be VAA's responsibility. From 2007, managing a list of businesses that provide accounting services will officially be under VAA's supervision. In addition, from 2008, VAA and MOF will jointly organize examinations and issue certified public accountant and certified auditor certificates. VAA and VACPA also participate in formulating accounting and auditing standards. (Status: fully complied)

58. Condition 2-11 requires MOF to have adopted a set of ethical rules for the accounting and auditing profession consistent with international best practice. The code of ethics was issued in 2005. VAA will be responsible for monitoring compliance with the code of ethics for the accounting profession, while VACPA will be responsible for overseeing the code of ethics for auditors. (Status: fully complied)

b. Secured Transactions System

i. Launching a Public Registry for Secured Transactions

59. Condition 2-12 requires the Ministry of Justice (MOJ) to have submitted to the Standing Committee of the National Assembly a draft ordinance on registering secured transactions containing all procedural requirements for registration and adopting measures listed under the comprehensive review. The Government has made steady progress toward developing nationwide a computerized secured transactions registration system. In 2002, registration centers for asset transactions were established in Hanoi, Ho Chi Minh City, and Da Nang under the management of the National Registry Agency for Secured Transactions. Additional efforts were made to streamline registration procedures.

60. Decree 08 and Decree 167 currently provide the legal bases for registering secured transactions. MOJ began the process of improving the legal framework by drafting the ordinance in December 2003 with the support of ADB TA 4060⁹ and the Japan International Cooperation Agency. The seventh draft, developed after a series of consultations, was submitted on 30 October 2006 to the Standing Committee of the National Assembly for review. After receipt of comments from the committee, the draft will be revised and submitted for final approval in 2007. The draft ordinance will be divided into two parts and will have a framework for both movable and immovable assets. The registration of movable assets will come under the jurisdiction of MOJ, while registration related to land will be carried out by the Land Registration Office under the Ministry of Natural Resources and Environment. No conflicts regarding the roles of the two ministries are apparent in the draft. In parallel, a project is being implemented to computerize the registration of secured transactions, which is expected to become operational by the second quarter of 2007. The modernization project financed by ADF will support the online registration of secured transactions. (Status: fully complied)

c. Deposit Insurance System

i. Strengthening the Deposit Insurance System

61. Condition 2-13 requires SBV, in cooperation with Deposit Insurance of Viet Nam (DIV), to submit to the Government an amendment to the decree on deposit insurance to allow DIV to (i) charge differential premiums depending on types of institutions covered; (ii) borrow from the Government, issue bonds in accordance with the prevailing regulations on issuance of bonds, and borrow from commercial banks; and (iii) specify strict conditions under which DIV provides financial support to problem banks.

62. The Government issued Decree 109 on 24 August 2005 to replace Decree 89 on deposit insurance. Item 4 of Decree 109 allows DIV to charge differential premiums based on certain implementation guidelines that need to be approved by the Prime Minister. Detailed guidelines are being prepared by DIV, creating a framework for risk-based classification of credit institutions and defining premium levels for each category of credit institution. Item 10 of Decree 109 allows DIV to mobilize capital by (i) receiving loans or special support capital from the Government, (ii) issuing bonds according to the provisions of relevant law, and (c) obtaining loans from credit institutions or other organizations with the Government's guarantee. Item 6 of Decree 109 provides strict conditions for extending financial support to problem banks. (Status: fully complied)

63. Condition 2-14 requires SBV and DIV to complete a feasibility study to determine the appropriate model for protecting depositors in people's credit funds (PCFs). Despite DIV being the appropriate organization to protect depositors in general, and DIV having paid out to 1,353 depositors in 32 failed PCFs for a total amount of D14.067 trillion, SBV is of the view that there is a need to set up the safety fund due to the nature of operations of the PCFs. This will ensure the financial soundness and sustainability of PCFs, help prevent PCF failures, and ensure depositor protection. In July 2006, SBV held a conference to review the pilot implementation of the safety fund for PCFs in Thai Binh Province. With the pilot rated successful, the governor of SBV directed considering the possibility of expanding the safety fund model to Hung Yen and An Giang provinces. As the policy condition requires only SBV and DIV to jointly complete a feasibility study to determine the appropriate model for protecting depositors in PCF, the

⁹ ADB. 2003. *Technical Assistance to the Socialist Republic of Viet Nam for Legal System Development Up to Year 2010 and Capacity Building for Secured Transactions Registration*. Manila.

condition can be treated as fulfilled in that insurance is already provided by DIV for PCF depositors. Notwithstanding the above and with the intention of ensuring the financial soundness and sustainability of these PCFs which is outside the present coverage of DIV, a study was undertaken by SBV with the assistance of an international consultant on credit cooperative system under ADB TA 4290 to draft the plan for establishing the safety fund. In addition, a working group has been established for developing a model for establishing a nationwide safety fund for PCFs, expected to be set up by July 2007. (Status: fully complied)

d. Anti-Money Laundering System

i. Establishing an Anti-Money Laundering System

64. Condition 2-15 requires the Government to (i) establish a financial intelligence unit with adequate staffing and internal procedures and (ii) ensure the development of a compliance program in consultation with the financial sector. In 2002, the Government of Viet Nam decided to prepare a foundation for government agencies' prevention and combat of money laundering and advised SBV to develop a draft decree in consultation with all relevant government agencies. The draft decree was originally prepared with assistance provided under ADB TA 4290 (see footnote 1). Decree 74/2005/ND-CP was signed by the Prime Minister on 6 June 2005 and took effect on 1 August 2005, creating the legal framework for AML. An essential element of AML is the existence of financial intelligence to receive and analyze financial intelligence. This is also defined in the Decree 74.

65. The Government established the AML Information Center in SBV in September 2005, with five staffers officially delegated to it (the number expected to rise to 10 in 2006). Since AML is considered a new and sensitive subject, SBV conducted an assessment of the possible impact of the decree and submitted it to the Prime Minister in 2005. Gradual implementation has been adopted, under which the decree is applied first to credit institutions. The governor of SBV issued detailed implementing guidelines in June 2006 that require credit institutions to report large and suspicious cash transactions in a unified format from 1 August 2006. In addition, credit institutions have to put in place internal AML procedures and staff responsible for AML and to submit to SBV their reports on the status of compliance by 30 September 2006. SBV will undertake inspections to review compliance with AML regulations and provide necessary clarifications. To support the operation of the AML Information Center, an information technology system for the AML database is being designed by the Information Technology Department of SBV. (Status: fully complied)

C. Status of Policy Actions for Third Tranche

66. Reforms are on track, and progress is satisfactory on compliance with third tranche release conditions, which was originally due for release in March 2007 but will likely be extended to 30 June 2007. Two critical legislations relating to the NI Law and Securities Law—both originally due for passage in 2007—were approved in 2006. The implementation guidelines for the NI law have also been issued, and the Securities Law will become effective in January 2007. Good progress has also occurred in the insurance sector with MOF requiring insurance companies to adopt compliance manuals and establish compliance committees.

IV. CONCLUSIONS

67. The Government has made significant progress in implementing reforms and enhancing financial sector implementation under Subprogram II of FSPL II. The relevant agencies' commitment to successfully implementing the second tranche of Subprogram II of FSPL II was clearly evident throughout the implementation period, thus justifying the release of the second tranche of \$15million equivalent.

V. THE PRESIDENT'S DECISION

68. In view of the solid progress made in implementing Subprogram II of the Financial Sector Program Loan II and the Government's accomplishment of all 15 conditions of the second tranche, the President is satisfied with the overall implementation of the program and that the necessary conditions for release of the second tranche have been fulfilled. In accordance with the established procedures, the release of the second tranche amount of SDR 10,185,000 from ADF (\$15 million equivalent) under FSPL II Subprogram II will be effective not less than 10 working days from the date of circulation of this progress report.

POLICY MATRIX
Financial Sector Program Loan II Subprogram II
(Second Tranche Condition)

A. Insurance Sector

Development Objective	Subprogram II	Current Status
	Second Tranche Conditions	
Creating equal opportunities to enhance the competitiveness of the insurance market	2-1. The Ministry of Finance (MOF) to issue minimum terms and conditions of insurance for each class of compulsory insurance	Fully Complied Technically, no new laws (decrees, circulars or otherwise) were enacted during the program period to introduce additional compulsory insurance categories and therefore it was not necessary for MOF to issue any minimum terms and conditions. To further reforms in the insurance sector, MOF has now submitted a draft decree on traveler insurance, with minimum terms and conditions of insurance for this category expected to be issued within 3-6 months of the decree being issued. Currently only third party insurance (personal and property) is compulsorily required under MOF. Decision 23 on motor liability insurance, issued in February 2003, includes minimum terms and conditions.
Strengthening supervision and prudential regulations	2-2. MOF's insurance department to submit a capacity-building plan to MOF, including human resource and training programs, to effectively exercise state management functions over the insurance through planning, policy formulation, prudential principles, supervision, and implementation	Fully Complied A capacity-building plan was submitted by the Insurance department to MOF on 30 October 2006. Many elements of the submitted plan are already in place, including a training schedule for MOF insurance department staff. The plan is being implemented with the staff undergoing various training programs, both in Viet Nam and overseas.
	2-3. MOF to introduce regulations that require an appointed actuary approved by MOF to sign off on reserves in the annual accounts	Fully Complied Circular 98, dated October 2004, includes the legal obligation that an appointed actuary sign off, but this requirement pertains to only life insurance, as signing off authority for other forms of insurance does not necessarily require actuarial skills.
Developing insurance infrastructure	2-4. MOF to support the Association of Vietnamese Insurers' adoption of a code	Fully Complied MOF has forwarded letter 11443 of 18 September 2006 to the

Development Objective	Subprogram II	Current Status
	Second Tranche Conditions	
	of conduct for insurance brokers and agents	Insurance Association together with the draft of the uniform code of conduct recommending its adoption by insurance agents and brokers. For non-life insurance, codes of conduct on fair insurance and chief owner liability were adopted. For life insurance, a code of conduct for agent recruitment was adopted. MOF also established a forum for all life insurance companies to improve codes of conduct. This condition has been completed insofar as MOF supports such codes.

B. The Leasing Sector

Development Objective	Subprogram II	Current Status
	Second Tranche Conditions	
Establishing a regulatory environment conducive to business development and clear ground rules for contract enforcement	2-5. The State Bank of Viet Nam (SBV) to revise Decree 16 to (i) allow leasing companies to provide both finance and operating leasing and (ii) stipulate procedures and methods to deal with leased assets in cases where the lessee violates the lease contract	Fully Complied SBV revised Decree 16 to include conditions as stipulated in 2-5, and the revised Decree 16 was issued in May 2005. (Note: Article 1.28 of Decree 16 outlines procedures for the enforcement of leasing contracts. Essentially, lessors have the right to take possession of leased assets in the event of contract violation without having to take the lessee to court. It also limits the ability of the lessee to delay the process. The lessor is required to dispose of the recovered asset within 60 days and must return any excess funds recovered to the lessee. The lessee remains liable for any shortfall.)
Organizing activities for public awareness and capacity building	2-6. SBV to support and recognize a leasing industry association when it is established by the leasing companies	Fully Complied The Ministry of Home Affairs issued Decision 1004, dated 10 July 2006, approving the establishment of the Viet Nam Leasing Association.

C. Interbank/Money Markets

Development Objective	Subprogram II	Current Status
	Second Tranche Conditions	
Developing money market instruments	2-7. SBV to submit the draft Negotiable Instruments Law to the Government	Fully Complied The Negotiable Instruments Law was approved on 9 December 2005 and is effective from July 2006. SBV held two seminars, one each in Ho Chi Minh City and Hanoi, to enhance public awareness of the NI Law.

D. Capital Markets

Development Objective	Subprogram II	Current Status
	Second Tranche Conditions	
Broadening the capital market base	2-8. The Government to amend Decree 64 to provide equitizing state-owned enterprises (SOEs) with incentives, including tax incentives, for listing	Fully Complied MOF Document 11924 TC/CST of October 2004 and 5248/TC-CST of 29 April 2005 reduces corporate income tax by half for the first 2 years of listing and exempts newly- established fund management companies and securities companies from tax for the first 3 years of operation and reduces its corporate income tax by half for the next 2 years. In addition, the MOF has established a steering board to provide incentives for companies to list in the stock exchange. The number of companies listed increased from 20 in 2004 to 53 in September 2006 while market capitalization increased from 3% to over 7% of GDP during the same period. Decree 187/2004/ND-CP on SOE equitization issued in 2004 replaces Decree 64/2002/ND-CP of 2002 requiring SOEs under equitization with a public offering of 10% of equity capital or above to auction their shares on the stock market rather than via securities firms. Article 36 of the above Decree provides incentives for equitization of SOEs. In April 2005, Decision 528 was issued on 14 June 2005 which requires 250 SOEs to be equitized and listed and also requires MOF to provide

		guidance on tax incentives for SOEs listing in the local trading centers. Further, the Law on Securities and Securities Market has enhanced the disclosure requirements for unlisted companies, thereby reducing the gap in disclosure requirement between listed and unlisted companies.
Developing a self-regulatory organization (SRO)	2-9. The State Securities Commission (SSC) to support a securities dealers and brokers association (or securities industry association) as an SRO to issue a code of conduct for securities dealers and brokers	Fully Complied SSC has concluded a cooperation and assistance agreement with the Viet Nam Association of Securities Brokers (VASB) and supported preparation of the code of conduct by providing reference documents. Supporting VASB's issuance of the code of conduct and monitoring of compliance are the initial steps toward VASB assuming SRO status. The code was issued on 22 November 2006.

E. Financial Market Infrastructure

1. Accounting and Auditing System

Development Objective	Subprogram II	Current Status
	Second Tranche Conditions	
Strengthening the SRO function in the accounting enforcement system	2-10. MOF to strengthen Viet Nam Accounting Association (VAA) and work with VAA to develop a plan for VAA to assume responsibilities as an SRO	Fully Complied MOF has prepared a strategy to 2010 for developing the accounting profession, under which a section has been devoted to VAA. With support from ADB TA 4290, a 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. Decision 47 was issued on 7 July 2005 and provides for the transfer of certain oversight responsibilities over certified public accountants and certified auditors to VAA and VACPA. From 2006, responsibility for accounting issues will fall under VAA, while auditing issues will fall under VACPA. Training programs for examinations and to provide updates on new accounting policies will be VAA's responsibility. From 2007, managing a list of businesses providing accounting services will officially be under VAA's supervision. In addition, from 2008 VAA and MOF will jointly organize examinations and sign certified public accountants and certified auditors certificates. Introducing international accounting standards falls

Development Objective	Subprogram II	Current Status
	Second Tranche Conditions	
		under MOF, though VAA and VACPA can participate in developing these standards.
	2-11. MOF to adopt a set of ethical rules for the accounting and auditing profession consistent with international best practice	Fully Complied MOF Decision 87/2005 of 1 December 2005 relates to the introduction and promulgation of the Code of Professional Conduct on Vietnamese Auditing and Accounting. VAA will be responsible for the code of ethics in the accounting profession, while VACPA will be responsible for overseeing the code of ethics of auditors.

2. Secured Transactions System

Development Objective	Subprogram II	Current Status
	Second Tranche Conditions	
Launching public registry for secured transactions	2-12. MOJ to submit to the Standing Committee of the National Assembly a draft ordinance on the registration of secured transactions containing all procedural requirements for registration and adopting measures listed under the comprehensive review	Fully Complied The draft ordinance was submitted under letter 3571/BTP of 30 October 2006 to the Standing Committee of the National Assembly. After receipt of comments from the committee, the draft will then be revised and submitted for final approval by the second quarter of 2007.

3. Deposit Insurance System

Development Objective	Subprogram II	Current Status
	Second Tranche Conditions	
	2-13. SBV, in cooperation with Deposit Insurance of Viet Nam (DIV), to submit to the Government the amendment of the decree on deposit insurance to allow DIV to (i) charge differential premiums depending on types of covered institutions; (ii) borrow from the Government, issue bonds in accordance with the prevailing regulations on issuance of bonds, and borrow from commercial banks; and (iii) specify strict conditions under which DIV provides financial support to problem banks.	Fully Complied This condition can now be considered fully complied with, with the amendment of Decree 89 with Decree 109 on 24 August 2005. Item 4 of Decree 109, when read with Article 6 of Decree 89, allows DIV to charge differential premiums based on certain implementation guidelines that need to be approved by the Prime Minister. Item 10 of Decree 109 is an amendment of Article of 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 relevant law, and (c) obtaining loans from credit institutions or other organizations with the Government's guarantee. Article 14 of Decree 89 and the amendment of Article 15 of Decree 89, with item 6 of Decree 109, provide strict conditions for extending financial support to problem banks.
	2-14. SBV and DIV to complete a feasibility study to determine the appropriate model for protecting depositors in people's credit funds (PCFs)	Fully Complied As the policy condition requires only SBV and DIV to jointly complete a feasibility study to determine the appropriate model for protecting depositors in PCFs, this condition can be treated as fulfilled in that the insurance is already being provided by DIV for PCF depositors. Notwithstanding the above and with the intention of ensuring the financial soundness and sustainability of these PCFs which is outside the present coverage of DIV, a study was undertaken by SBV with the assistance of an international consultant on credit cooperative system under ADB TA 4290 to draft the plan for establishing the safety fund. In addition, a working group has been established for developing a model for establishing a nationwide safety fund for PCFs, expected to be set up by July 2007. Furthermore, in July 2006, SBV held a conference to review the pilot implementation of the safety fund for PCFs in Thai Binh

Development Objective	Subprogram II	Current Status
	Second Tranche Conditions	
		province. With the pilot rated successful, the Governor of SBV directed considering expansion of the above safety fund model to Hung Yen and An Giang provinces.

4. Anti-Money-Laundering

Development Objective	Subprogram II	Current Status
	Second Tranche Conditions	
Establishing an anti-money laundering (AML) system	2-15. The Government to (i) establish the financial intelligence unit with adequate staffing and internal procedures and (iii) ensure the development of a compliance program in consultation with the financial sector	Fully Complied Based on SBV Decision 1002/QD-NHNN of 8 July 2005, the Government established an AML Information Center in SBV in September 2005, with five staffers officially delegated to it (the number expected to reach 10 in 2006). SBV Decision 1445/QD-NHNN OF 6 October 2005 provides for functions, tasks, power, and organizational structure of AMLIC. As AML is considered a new and sensitive subject, following the decree on AML promulgated in August 2005, SBV has conducted an assessment of the possible impact of the decree and submitted it to the Prime Minister in 2005. Gradual implementation has been adopted, under which the decree is first applied to credit institutions. The governor of SBV issued detailed implementing guidelines in June 2006 that require credit institutions to report large and suspicious cash transactions in a unified format from 1 August 2006. In addition, credit institutions have to put in place internal AML procedures and staff and submit to SBV their reports on the status of compliance by 30 September 2006. SBV also plans to conduct missions to review compliance with AML regulations and provide necessary guidance and clarifications. This will be further facilitated by the follow-up ADB TA 4731: Support to Implement the AML Decree, which is scheduled to commence from 27 November 2006.

KEY GOVERNMENT MEASURES AND PERFORMANCE INDICATORS

Key Government Measures

- Viet Nam joined the Asian Development Bank–Organization for Economic Co-operation and Development Initiative for Anticorruption in Asia and the Pacific in July 2004.
- Law to prevention and combat 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.
- New Investment Law, passed in November 2005, to create a level playing field for foreign and domestic private firms and state-owned enterprises (SOEs). The law encourages private sector participation in various forms.
- Competition Law passed in December 2004 that prohibits firms with market shares in excess of 50% to conduct mergers and outlaws cartels and pyramid structures.
- Law on Securities and Securities Market was passed by the National Assembly in June 2006 and will become effective in January 2007. It broadens the market base including both listed and unlisted securities, enhances the regulatory framework and authority of the State Securities Commission (SSC), and strengthens disclosure and corporate governance requirements.

Financial Sector Program Loan II Subprogram II

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 simultaneously monitoring and reducing systemic risks.

Insurance

- Circular 98/2004TT-BTC, dated 19 October 2004, on implementation guidelines for the law on business insurance.
- The time for product approval for most non-life products has been shortened from 7 days to 3 days.
- Circular 98 stipulates that all life insurers need to have approved actuaries on staff.
- Circular 99, issued on 19 October 2004, strengthens reserve and solvency norms and requires signing off by an auditor acceptable to the Ministry of Finance (MOF).

- Decision 23 on motor liability insurance was issued in February 2003, including minimum terms and conditions.
- Action plan adopted by MOF to develop the capacity of the its insurance supervisory department.

Leasing

- Decree 16 allows leasing companies to engage in activities other than financial leasing.
- On 19 May 2005, the Ministry of Justice (MOJ) issued Circular 04/2002/TT-BTP, providing guidelines on the registration of, and information on, finance leased assets, requiring all contracts on financial leasing to be registered at National Registry Agency for Secured Transactions.
- MOJ subsequently issued Circular 09/2005/TT-BTP on 6 December 2005, which provides guidance on (i) the authority, tasks and powers of the registration agency in the registration of, and provision of information on, finance-leasing contracts and (ii) the order and procedures for the registration of, and provision of information on, finance-leasing contracts.
- Article 1.28 of Decree 16 outlines procedures for enforcing leasing contracts.
- The Ministry of Home Affairs issued Decision 1004, dated 10 July 2006, approving the establishment of the Vietnam Leasing Association.

Interbank Money Markets

- The Negotiable Instruments Law was approved on December 2005 and went into effect in July 2006.

Capital Markets

- MOF Document 11924 /TC-CST of October 2004 and 5248/TC-CST of April 2005 provides tax incentives for listed companies for the first 2 years of listing and for newly established fund management companies and securities companies.
- The Hanoi Stock Trading Center opened on 5 March 2005.
- The Law on Securities and Securities Market was approved by the National Assembly in June 2006.
- Decree 48 has been replaced by Decree 144, which covers Decision 01/QD-QDT, dated 24 March 2004, of the chairman of SSC with regard to the license for establishing the securities investment fund and the issuance of the fund certificates to the public for Vietnam Fund 1 and (i) SSC's authority to regulate initial public offering, (ii) securities listing, (iii) two new provisions on information disclosure, (iv) securities investment funds, and (v) the depository center.
- The Securities Depository Center was established in Hanoi in August 2006.

Financial Market Infrastructure

Accounting

- MOF has issued 26 accounting standards and 33 statements on auditing as of the end of May 2005.
- Decision 47, issued on 7 July 2005, provides for transferring certain oversight responsibilities over certified public accountants and certified auditors to the Vietnamese Accounting Association and the Viet Nam Association of Certified Public Accountants.

Secured Transaction System

- MOJ submitted to the Standing Committee of the National Assembly on 30 October 2006 a draft ordinance on the registration of secured transactions containing all procedural requirements for registration.

Deposit Insurance

- Decree 109, when read with Article 6 of Decree 89, allows Deposit Insurance of Viet Nam (DIV) to charge differential premiums based on certain implementation guidelines.
- Decree 109 amends Article 19 of Decree 89 and 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 relevant law, and (c) obtaining loans from credit institutions or other organizations with the Government's guarantee.
- Article 14 of Decree 89 and 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 (AML)

- AML Decree 74/2005/ND-CP was signed by the Prime Minister on 6 June 2005.
- A financial intelligence unit was established in June 2006 under the State Bank of Viet Nam to record and monitor large and suspicious cash transactions.
- A proposal dated 14 December 2005 urges joining international and regional organizations against money laundering.

Design Summary	Targets/Measurable Indicators	2000	2001	2003	2005
Develop a financial system with better financial intermediation, efficiency, and accessibility.	Gross domestic product (GDP) growth (%)		6.9	7.3	8.4
	Increased money supply (M2)/ GDP (%)	50		71	79
	Increased domestic savings and foreign direct investment (%)	20 (1995)	26	27	32
	Investment to GDP ratio (%)		32.1	33.9	37.6
	Share of private sector in total investment (%)		23	27	32
	Share of state-owned enterprises in total investment (%)		60	54	52
	Bank credit to private sector (%)		58	65	68
	Interest rate deregulation in August 2002, which enables banks in principle to price their loans according to credit risk			deregulated	deregulated
Develop alternative channels of market-based financial intermediation.	Equity Market Capitalisation (D trillion)	1.5	1.6	2.4	47.5
	Equity Market Capitalisation (% of GDP)	3.0	3.3	3.9	6.1
	Listed companies	5	11	22	51
	Listed bonds issues	4	18	103	281
	Listing bonds par value (D trillion)	1.2	2.9	11.7	33.9
	Listing bonds value (% of GDP)	0.3	0.6	2.0	3.5
	Insurance revenue from premium (D trillion)			10.4	15.6
	Insurance revenue from premium (% of GDP)			1.7	2.3
	Number of leasing companies				9
	Total leased assets (D trillion)			7.2 (2004)	8.9

Sources: State Bank of Viet Nam and State Securities Commission of Viet Nam