



Report and Recommendation of the President to the Board of Directors

Project Number: 37577
November 2010

Proposed Loan for Subprogram 2 Socialist Republic of Viet Nam: Third Financial Sector Program

Asian Development Bank

CURRENCY EQUIVALENTS

(5 November 2010)

Currency unit	–	dong (D)
D1.00	=	\$0.000051
\$1.00	=	D19,490

ABBREVIATIONS

ADB	–	Asian Development Bank
IMF	–	International Monetary Fund
IAS	–	international accounting standards
IOSCO	–	International Organization of Securities Regulators
MMOU	–	multilateral memorandum of understanding
MOF	–	Ministry of Finance
PPPF	–	Post-program partnership framework
SBV	–	State Bank of Vietnam
SSC	–	State Securities Commission
TA	–	technical assistance
VSD	–	Vietnam Securities Depository

NOTES

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

Vice-President	C. Lawrence Greenwood, Jr., Operations 2
Director General	K. Senga, Southeast Asia Department (SERD)
Director	J. Ahmed, Financial Sector, Public Management and Trade Division, SERD
Team leader	H. Omar, Senior Financial Sector Specialist, SERD
Team members	L. A. Abenojar, Administrative Assistant, SERD T. Hla, Economist, SERD M.V. Mina, Assistant Project Analyst, SERD C. Minh, Financial Sector Officer, Viet Nam Resident Mission, SERD R. O'Sullivan, Principal Legal Counsel, Office of the General Counsel S. Schuster, Senior Financial Sector Specialist, SERD M. L. Ventura, Associate Project Analyst, SERD
Peer reviewers	R. Poddar, Senior Treasury Specialist, Treasury Department A. C. Schou-Zibell, Senior Economist, Central and West Asia Department

In preparing any country program or strategy, financing any project, or by making any designation of or reference to a particular territory or geographic area in this document, the Asian Development Bank does not intend to make any judgments as to the legal or other status of any territory or area.

CONTENTS

	Page
PROJECT AT A GLANCE	
I. THE PROPOSAL	1
II. THE PROGRAM	2
A. Rationale	2
B. Impact and Outcome	5
C. Outputs	5
D. Program Costs and Financing	7
E. Implementation Arrangements	8
III. DUE DILIGENCE	8
A. Fiduciary Assessment	8
B. Poverty and Social Impact Assessment	9
C. Safeguards	9
D. Risks and Mitigating Measures	9
IV. ASSURANCES	10
V. RECOMMENDATION	10
APPENDIXES	
1. Design and Monitoring Framework	11
2. List of Linked Documents	14
3. Development Policy Letter	15
4. Policy Matrix and Post-Program Partnership Framework	20

PROJECT AT A GLANCE

1. Project Name: Financial Sector Development Program III		2. Project Number: 37577	
3. Country: Viet Nam, Soc Rep of		4. Department/Division: Southeast Asia Department Financial Sector, Public Management and Trade Division	
5. Sector Classification:	Sectors	Primary	Subsectors
	Finance	√	Money and capital markets
			Banking systems
			Insurance and contractual savings
6. Thematic Classification:	Themes	Primary	Subthemes
	Economic growth	√	Promoting macroeconomic stability Promoting economic efficiency and enabling business environment
	Capacity development		Organizational development Institutional development
	Governance		Economic and financial governance Anticorruption
	Private sector development		Policy reforms
6a. Climate Change Impact:		6b. Gender Mainstreaming:	
Adaptation		Gender equity theme	
Mitigation		Effective gender mainstreaming	
		Some gender benefits	
		No gender elements	
7. Targeting Classification:		8. Location Impact:	
General Intervention	Targeted Intervention		
	Geographic dimensions of inclusive growth	Millennium Development Goals	Income poverty at household level
√			
		Rural	
		Urban	
		National	High
		Regional	
9. Project Risk Categorization: Complex			
10. Safeguard Categorization:			
		Environment	C
		Involuntary resettlement	C
		Indigenous peoples	C
11. ADB Financing:			
	Sovereign/Nonsovereign	Modality	Source
	Sovereign	Program loan	Asian Development Fund
	Total		60.0
12. Cofinancing:			
No Cofinancing available.			
13. Counterpart Financing:			
No Counterpart Financing available.			
14. Aid Effectiveness:			
		Parallel project implementation unit	No
		Program-based approach	Yes

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed loan to the Socialist Republic of Viet Nam for subprogram 2 of the Third Financial Sector Program.¹

2. The Asian Development Bank (ADB) has supported the development of Viet Nam's financial sector since 1996 through program loans and technical assistance (TA). Subprogram 2 is built on earlier initiatives to help address the continuing need for financial sector development in Viet Nam. The first Financial Sector Program (1996–2002) facilitated the developing of legal and regulatory foundations for commercial banking.² The Second Financial Sector Program (2002–2006) promoted the development of the nonbank financial subsector, particularly insurance and leasing, and the anti-money laundering regime.³

3. The objective of the Third Financial Sector Program⁴ is to create a more diversified, deeper, and more resilient financial sector. By increasing the share of nonbank financial markets in financing investment, the program will contribute to enabling sustained growth in the economy with reduced risks due to funding mismatch. Greater scope and efficiency of alternative nonbank financial intermediation channels will strengthen stability of the financial sector through increased competition. Financial sector reforms aimed at mitigating risks of sector instability help reduce the vulnerability of the poor falling into poverty arising from financial sector crisis. This is supported by the recent International Monetary Fund (IMF) study involving 65 developing countries, which found that (i) financial sector development raises economic growth and reduces poverty, (ii) financial sector development directly reduces poverty by increasing the investment and interest incomes of the 20% poorest households, and (iii) financial sector instability directly reduces incomes of the poor thereby increasing poverty.⁵

4. The program cluster comprises two subprograms covering the period from January 2006 to September 2010. The program is in line with Strategy 2020⁶ as well as the government's Socio-Economic Development Plan 2006–2010 and ADB's country strategy and program for 2007–2010,⁷ which all support business-led pro-poor growth by promoting infrastructure development, creating a business-enabling environment, and developing diversified financial intermediation. A total loan of \$135 million from ADB's Special Funds resources was allotted for the program—\$75 million for subprogram 1 and \$60 million for subprogram 2.

5. **Subprogram 1.** Actions under subprogram 1 were undertaken in two phases from January 2006 to February 2009. At the request of the government, the implementation period for the second tranche was extended to 31 December 2009 to allow for additional time to complete the

¹ The design and monitoring framework is in Appendix 1.

² ADB. 1996. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Technical Assistance Grant to the Socialist Republic of Viet Nam for the Financial Sector Program*. Manila.

³ ADB. 2002. *Report and Recommendation of the President to the Board of Directors: Proposed Program Loan Cluster to the Socialist Republic of Viet Nam for the Second Financial Sector Program*. Manila.

⁴ ADB. 2007. *Report and Recommendation of the President to the Board of Directors: Proposed Program Loan Cluster and Loan to the Socialist Republic of Viet Nam for the Third Financial Sector Program*. Manila. (Loan 2377 for \$75,000,000, approved on 6 December).

⁵ S. G. Jeannwney and K. Kpodar. 2008. Financial Development and Poverty Reduction: Can there be benefit without a cost? *IMF Working Paper*. No. 62. Washington, DC. The authors estimate quite large coefficients on the financial sector development variables, i.e., a 10% increase in the broad money (M3) to gross domestic product (GDP) ratio raised the incomes of the 20% among the poorest households by 3% to 5%.

⁶ ADB. 2008. *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank, 2008–2020*. Manila.

⁷ ADB. 2006. *Country Strategy and Program: Viet Nam, 2007–2010*. Manila.

policy actions.⁸ Compliance with 25 of 27 conditions has been achieved,⁹ while the submission of a draft law on auditing to the government was subsequently accomplished and the requirement for an anti-money laundering information center to establish an information technology system to collect, process, and record information is ongoing, justifying the release of the second tranche of \$45 million. The successful completion of subprogram 1 justifies the program loan to proceed with implementation of subprogram 2.

6. **Subprogram 2.** Actions under subprogram 2 cover the period from March 2009 until September 2010. The subprogram focus is on development of securities and bond markets; increasing transparency disclosure; and strengthening the legal, regulatory, and enforcement frameworks. It provides support for government efforts to strengthen regional cooperation by enhancing cooperation with regulators in other securities markets in the region.

7. The focus of priorities under subprogram 2 has been refined since its formulation in 2006 to reflect the impact and lessons from the global financial crisis (2008–2009) and the need to emphasize measures to strengthen financial stability. The refinement includes additional and explicit emphasis on financial stability and human resource development. With these refinements, the program loan now comprises 21 policy actions of which 14 are core actions that have all been accomplished. The remaining 7 actions are completed milestones.¹⁰ The development policy letter is in Appendix 3 and the policy matrix and post-program partnership framework are in Appendix 4.

II. THE PROGRAM

A. Rationale

8. Financial sector development in transitional economies is a complex, long-term effort. Over the past decade, the government has embarked on financial sector reform to transform and modernize the country's financial sector. Through program and TA (footnotes 2-4), ADB has supported the government in addressing these critical bottlenecks in financial sector infrastructure, institutional capacity, and the legal and regulatory framework. The ADB Country Assistance Program Evaluation for Viet Nam recommended a continuous support for the financial sector.¹¹

9. Financial sector reforms require support over the medium to long term. Reforms supported under this and earlier programs have been integral to supporting Viet Nam's gradual transition from a centrally planned to a market-based economy and in helping the government achieve and sustain high rates of economic growth. This was instrumental in the country's remarkable progress with poverty reduction over the last decade. Viet Nam's recent rapid rate of economic growth has been underpinned by record investment.¹² Investment by the private sector, moreover, has grown much faster than that by the public sector. Following the acceleration of economic reforms, private sector investment has supplanted the public sector as the main contributor to capital accumulation during the program period, accounting for over 60% of total capital accumulation by 2007.¹³

⁸ The first tranche of \$30 million was released on 13 June 2008, and the second tranche of \$45 million was released in December 2009.

⁹ ADB. 2009. *Progress Report on Tranche Release : Third Financial Sector Program for Viet Nam*. Manila. (L 2377-VIE)

¹⁰ Justification for the Refinement of Some of the Original Indicative Actions for Subprogram 2 (accessible from the list of linked documents in Appendix 2) - originally, of the 14 original indicative actions under FSPL III-Subprogram 2, 7 were core actions. Of the 7 original core actions, 3 were accomplished, 3 had been partially accomplished, and 1 had not been completed. The remaining 7 indicative actions were the milestones.

¹¹ ADB. 2009. *Country Assistance Program Evaluation: Viet Nam*. Manila.

¹² Increasing from some 35% of GDP in 2001 to a remarkable 45% by 2007.

¹³ The same share the public sector held in 2001.

10. **Banks dominate intermediation.** While progress in developing the financial sector has been impressive, banking continues to dominate the sector—in particular state-owned commercial banks, which account for 51% of total aggregate loans. The IMF 2010 Article IV Consultation with Vietnam concludes that one of the fundamental problems facing Viet Nam is overbanking.¹⁴ Overall asset quality of the banking system has not been challenged by the financial crisis as nonperforming loans only accounted for 2.2% in June 2009. However, constraints for the continuing intermediation of banking include the limited scale of operations, credit risk, and funding mismatches. By increasing the share of nonbank financial markets in financing investments, subprogram 2 will continue to enable sustained high economic growth with reduced risks due to funding mismatch.

11. **Micro-prudential measures and major legal reform for banking.** In an effort to strengthen the financial stability of the banking system, the State Bank of Vietnam (SBV) introduced a number of key micro-prudential measures and initiated major legal reforms for the SBV Law and Credit Institutions Law. To improve banking capitalization, SBV identified consolidation of private joint stock banks as a priority along with equitization of state-owned commercial banks. It increased the minimum charter capital of joint stock banks to D3 trillion to be met by the end of 2010. Other key measures include a new solvency ratio and corporate governance requirements for banks, the extension of the bankruptcy law to commercial banks, formalization of SBV powers to place banks under special control, and the establishment of regulations to govern bank mergers.

12. **Measured progress in capital markets.** The number of publicly listed companies in the Ho Chi Minh City and Hanoi stock exchanges has increased significantly, from 41 in 2005 to 457 in 2009, and to 549 as of June 2010. Likewise, initial public offerings of equities averaged 3.25% of gross domestic product (GDP) for 2006–2009, reaching a peak of 9.14% in 2007. The total market capitalization value of Viet Nam of approximately \$39 billion is still small compared with other countries in the region. However, if state-owned enterprise reforms, including their equitization, remain on track, the size of the stock market may approach that of the Philippines (\$76 billion) and Thailand (\$166 billion). The State Securities Commission (SSC) has taken steps to enhance its supervisory capacity. The country now has 105 registered securities firms and 46 fund management companies.

13. However, continued efforts are needed to strengthen investor protection, and improve market transparency, corporate governance, and risk management capacity of market institutions. Subprogram 2 will support government efforts to limit the scope of unregulated markets for unlisted securities¹⁵ to encourage companies to increase their long-term capital and financing needs in the regulated capital markets.

14. **Government debt market.** The bond market has been impacted by the global financial crisis. Total outstanding value of government bonds as a percentage of GDP increased from 2.82% in 2001 to 8.16% in 2005, reaching its peak in 2007 at 10.28% before declining to 9.49% in 2008 and 8.25% in 2009. The debt market is largely dominated by government obligations. The most significant issue preventing the development of the bond market, other than lack of significant participants, is the lack of reliable and liquid benchmarks to establish a government yield curve. The government public debt profile is currently skewed toward the short end of the yield curve¹⁶; longer-term issuance needs to be considered in establishing the needed benchmarks. The

¹⁴ IMF Executive Board Concludes 2010 Article IV Consultation with Vietnam Public Information Notice No. 10/127, 8 September 2010.

¹⁵ Private equity markets.

¹⁶ These include those with yields ranging from 3 months to 12 months.

establishment of the Debt Management and External Finance Office (PDMO)¹⁷ with the passing of the Public Debt Management Law on 17 June 2009 is expected to significantly help address impediments to consolidating the management of public debt. The government has also embarked on a comprehensive review of Decree 141/2003/ND-CP, which governs the issuance of government bonds, government-guaranteed bonds, and municipal bonds, and Decree 52/2006/ND-CP, which regulates the issuance of corporate bonds.

15. **Support for the insurance industry.** The development of long-term savings institutions such as the insurance subsector is critical for mobilizing and allocating long-term savings into capital to further the economic development of the country. The insurance subsector continues to expand rapidly with annual insurance premiums growing tenfold over the past 10 years, to approximately \$1.2 billion. Nevertheless, only about 5% of Viet Nam's population is insured. The government recently amended the Law on Insurance Business to provide greater investor protection, and the Insurance Supervisory Authority has strengthened its capacity to protect policy holders. However, more emphasis needs to be given to capacity building of the insurance regulator to enhance the risk-based supervision framework to bring it into alignment with international best practice.

16. **Market information and transparency.** Viet Nam faces significant challenges in effectively adopting international accounting standards (IAS) and auditing standards. Given the complexity of the standards, the government has decided to initiate step-by-step implementation after completing comprehensive and thorough consultation and preparation. Further support is needed for the full adoption of IAS and auditing standards, including capacity building.

17. **Global financial crisis and lessons learned.** Progress on some of the indicative policy actions developed for subprogram 2 in 2006 has been difficult. First, the global financial crisis resulted in a change in the government's priorities for the financial sector, as was the case for Viet Nam's regional peers. For example, total stock market capitalization as a percentage of GDP reached its peak at 43.26% in 2007 before declining to 15.19% in 2008. Likewise, total outstanding value of Government bond as a percentage of GDP reached its peak in 2007 at 10.28% of GDP before declining to 8.25% in 2009. Second, the government is increasingly recognizing the need to create an institutional basis for its debt management. Third, focus is needed on development of the short end of the government securities market and augmented money markets (footnote 16). To support the government in meeting its revised priorities, subprogram 2 was refined based on the following four key considerations:

- (i) **Shift in priorities.** The reformulation recognizes the significant shift in government policy priorities for the financial sector following the global financial crisis—notably strengthened emphasis on key reforms to enhance the transparency, soundness, and stability of banking system.
- (ii) **Need to create an institutional basis for debt management.** While the global financial crisis presented unexpected challenges for the development of government bond markets, it also led to the recognition that existing arrangements for debt issuance pose significant impediments. The government recognizes the need to create an institutional basis for holistic reforms of its debt operations prior to embarking on significant market structure reforms.
- (iii) **Development of the short end of the government securities market and augmented money markets.** The refined program prioritizes the development of the short end of the bond market as part of a sequential approach to bond market

¹⁷ The abbreviation "PDMO" which is commonly used for Public Debt Management Office is used for the Debt Management and External Finance Office.

development. Subprogram 2 will support the government in improving the risk management and operating efficiency of money markets and open market operations of SBV to enhance liquidity in the secondary market.

- (iv) **Lessons from subprogram 2.**¹⁸ Finance sector reforms in transitional economies often recognize the need for a clearly defined step-by-step approach over the medium-to-long term as new institutions and concepts need to be introduced and related capacity built.

B. Impact and Outcome

18. The expected impact for the program is a more diversified, deeper, and resilient financial sector in Viet Nam. The outcome of the program will be an increased share of capital markets in financing domestic investment, which will promote and facilitate a sustained high growth rate in the economy with reduced refunding risks.¹⁹

C. Outputs

19. Subprogram 2 acknowledges the difficult environment faced by Viet Nam in the wake of global financial crisis during 2008–2009, and recognizes significant key measures initiated by SBV in 2009–2010 to mitigate the impacts of the crisis on the financial sector to ensure financial stability. While progress on some of the indicative policy actions developed for subprogram 2 during formulation of subprogram 1 in 2006 was difficult due to the fallout from the global financial crisis, significant progress in related areas has been achieved in response to the crisis to assure the soundness of commercial banks. Additionally, in other policy areas where program progress has fallen behind due to the impacts from the global financial crisis, new institutional approaches, such as the formation of PDMO, provide a basis for sounder and accelerated progress in implementing needed reforms for government debt. Although the direct impact of the crisis on accounting is not discernible, the original condition imposed for subprogram 2 on implementation of IAS 39 was refined due to market readiness issues for adopting this standard by 2010. Other significant progress includes major law reforms initiated across the financial sector—banking, securities, and insurance; the SSC Strategy 2010–2020 for long-term capital markets development; new disclosure requirements; various micro-prudential measures introduced by SBV; and related measures to strengthen the supervisory and regulatory regime.

20. **Output 1: Enhanced capital market liquidity through improved information disclosure.** Timely disclosure of material information reduces information asymmetries among market participants, strengthening investor confidence and supporting market liquidity. Subprogram 2 supports a new core policy action covering the new regulation issued by MOF requiring information disclosure of listed and unlisted public companies to move closer to the adoption of international best practices. Under a new core policy action, SSC completed a comprehensive analysis of a strategic development and sector road map for 2010–2020 to address market infrastructure bottlenecks for capital market growth. To address accounting standards, the government initiated a gap assessment to more closely align Vietnamese accounting standards with the IAS and developed an implementation timeline.

¹⁸ ADB. 2010. *Program Completion Report. Viet Nam Second Financial Sector Program Loan Cluster (Subprograms 1 and 2)*. Manila.

¹⁹ Refunding is the refinancing or [restructuring of debt](#) with new debt, equity, or a combination of both. Sometimes refunding involves the issuance of equity in order to decrease the proportion of debt in the borrower's capital structure. As a result of refunding, the maturity of the debt may be extended or reduced.

21. To enhance market information standards, the draft Law on Independent Audit was submitted to the government. To enhance information disclosure, the Vietnam Securities Depository (VSD) completed the pilot implementation of the automatic synchronization of records between its head office and branches for public companies registered with VSD. To strengthen VSD's risk management capacity, a risk assessment of its central depository and clearing functions benchmarked against international practices will be undertaken.²⁰

22. **Output 2: Strengthened institutional framework for securities issuance.** To develop the government securities market, the program supports institutional reforms such as the establishment of PDMO. Together with the Banking and Financial Institutions Department of MOF, PDMO will provide an institutional focal point to support a range of key reforms in the bond markets. To improve the risk management and operating efficiency of the money market, and open market operations for the development of a liquid secondary market, SBV will incorporate the short-term risk mitigation measures identified in the ADB TA report.²¹

23. **Output 3: Enhanced legal and regulatory framework for investor and consumer protection and financial sector stability.** The program supports a review of the legal framework for the Securities Law with a view to strengthening enforcement powers and investor protection. SBV, as part of its response to the global financial crisis, introduced measures to strengthen commercial banks including (i) adopting new corporate governance requirements based on the corporate governance principles of the Organization for Economic Co-operation and Development; (ii) increasing the charter capital of banks; and (iii) amending the SBV Law, Credit Institutions Law, and application of Bankruptcy Law on credit institutions, including special control by SBV in an effort to drive banking consolidation.

24. As part of its efforts to strengthen its anti-money laundering regime, Viet Nam joined the Asia/Pacific Group on Money Laundering and in July 2009 was evaluated by the group. A new core policy action supported under subprogram 2 is the submission of the draft amendments to the insurance law to the government by August 2010 and the issuance of a decree on administrative penalties for insurance businesses.

25. **Output 4: Improved regional cooperation and human resource development.** One of the conditions stipulated in subprogram 1 is for SSC to assess its ability to meet benchmarks under the International Organization of Securities Regulators (IOSCO) multilateral memorandum of understanding (MMOU) and to develop a road map for it to become a signatory to Annex B of the IOSCO MMOU. Viet Nam has been accepted as an IOSCO MMOU Annex B signatory; this is subject to government approval. The reformulated policy action for subprogram 2 requires MOF to submit a request to the government to approve Viet Nam's membership in the MMOU Annex B signatory. Subprogram 2 supports a systematic approach to capacity building for financial sector development. SBV is developing a 5-year human resource development plan to 2015 with a vision up to 2020. In line with this move, SBV will conduct a skill gap assessment to formulate a comprehensive capacity-building program.

26. **Post-program partnership framework.** Subprogram 2 includes a post-program partnership framework (PPPF) with high-impact policy actions²² and institutional development measures building on reforms and core actions under subprogram 2. This is to serve as a platform

²⁰ This assessment will be undertaken by December 2010.

²¹ ADB. 2010. *Review and Assessment of the Risks of the Operations of Central Banking Department of State Bank of Vietnam*. Consultant's Report. Manila (TA 4732-VIE).

²² Support under a policy and advisory TA for Financial Sector and Capital Market Development totaling \$1.5 million will be prepared and is under the technical assistance tentative category.

for further engagement with the government. The PPPF is outlined in the policy matrix (Appendix 4).

D. Program Costs and Financing

27. The government has requested a loan of SDR38,271,000 million equivalent from ADB's Special Funds resources to help finance subprogram 2. The loan will have an interest charge at the rate of 1.0% per annum during the grace period and 1.5% per annum thereafter; a term of 24 years, including a grace period of 8 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft program loan agreement. The government will use the local currency counterpart funds generated by the loan proceeds to meet program expenditures and associated costs of reform and to help maintain current social expenditures.

28. ADB funds will support reforms outlined in the development policy letter (Appendix 3) and policy matrix and post-program partnership framework (Appendix 4). The overall loan size is determined by the strength of the associated policy actions, their development impact, the importance of the sectors covered, the development financing needs of the government as indicated by MOF, and the government's financing needs during the country partnership strategy period. The program will imply some short-term, direct adjustment costs, including costs for (i) restructuring and capacity building for SSC, SBV, MOF, and capital markets self-regulatory organizations; (ii) operationalizing new institutions including capacity building (e.g., PDMO); (iii) enhancing supervisory agencies, and accounting and auditing agencies; (iv) introducing new standards and legislative reforms; and (v) developing money markets and open market operations, and developing bond markets. It is estimated that total short to medium term static gains under FSPL III from (i) improvement in banking sector efficiency, (ii) shift financing mix from bank loans to bonds, and (iii) reduce corporate default rates to benchmark rates, is at \$489 million or 0.6% of GDP. A long-term static gain from the reforms is estimated at \$4.8 billion or 5.5% of GDP. A total estimated adjustment cost from the program is about \$56.8 million.²³ The loan proceeds will be disbursed in accordance with the provisions of ADB's Simplification of Disbursement Procedures and Related Requirements for Program Loans.²⁴ The program will provide for the retroactive financing of eligible expenditures incurred up to 180 days prior to loan effectiveness. ADB will retain the right to audit the use of the loan proceeds and to verify the accuracy of the withdrawal application certification. The short-term, direct costs, however, do not incorporate the full direct costs of the policy package, which includes longer-term changes for institutions and processes.²⁵ While the direct reform costs maybe relatively modest, the program is expected to leverage substantial increase in the availability and access to finance through enhanced capital markets liquidity and strengthened legal and institutional framework.

29. The program loan also reflects the development financing needs of the government. The political costs of implementing the reforms are considerable, with vested interests benefiting from weak enforcement of regulations in financial markets and from the absence of adequate risk management, supervision, and transparency. Although the benefits of the reforms will far outweigh the costs, the benefits will materialize over time, while the costs are front loaded. In the absence of timely reforms, the economy will continue to bear the significant costs of inefficient intermediation and be exposed to systemic risks, perhaps most importantly currency and maturity mismatches,

²³ The Summary Impact Assessment (accessible from the list of linked documents in Appendix 2) provides details of the magnitude of the benefits and costs of the program. Total estimated adjustment costs of \$56.8 million include administrative, enforcement, fiscal and business compliance costs.

²⁴ ADB. 1998. *Simplification of Disbursement Procedures and Related Requirements for Program Loans*. Manila.

²⁵ The government accounting systems do not currently allow the segregation of the actual or future incremental costs attributable to implementation of the Third Financial Sector Program, subprogram 2.

and investors will be left vulnerable to misconduct and fraud. The government has demonstrated its strong commitment to financial sector reforms by initiating a number of core policy initiatives to safeguard stability of the financial system and to develop capital markets as reflected in the refinement of subprogram 2 program outputs.

30. **Accounting, auditing, and reporting to ADB.** SBV, as the executing agency, is required to submit a final report on the progress of the entire program cluster.

E. Implementation Arrangements

31. SBV is the executing agency for subprogram 2. MOF in coordination with the SSC, and its agencies (the Hanoi Stock Exchange, and VSD) are the implementing agencies. SBV is responsible for overall program implementation and administration, disbursement of loan proceeds, and monitoring.

32. To coordinate program implementation among different government ministries and agencies concerned, a program steering committee was formed, chaired by SBV and comprising senior officers from all government agencies concerned.

III. DUE DILIGENCE

A. Fiduciary Assessment

33. The government's public financial management reforms are at an early stage but steady progress is being made in improving the legislative and institutional framework. The National Assembly promulgated the Law on Public Debt Management in June 2009. The law provides a legal framework for a modern debt management system to monitor public debt, analyze its profile, and resolve and manage related fiscal risks.

34. Implementation of the 2002 Budget Law is progressing. Budget coverage in Viet Nam is reasonably comprehensive, but still incomplete compared to international practices. The State Budget Law needs to be updated. The Government has piloted a medium-term expenditure framework in several sectors, but it needs to be scaled up and mainstreamed in the annual budget cycle. The World Bank's assessment suggests that the fiduciary risks of the current public financial management systems (budgeting, accounting, reporting and auditing) are moderate.²⁶

35. A new integrated computerized financial management system (Treasury and Budget Management Information System) was rolled out in 2008 to strengthen expenditure management and control. A road map for adoption of international public sector accounting standards was approved to provide the basis for preparing government financial statements that are more in line with international practices.

36. The government is also developing the building blocks for improved governance and anticorruption measures. Since 2005, implementation of the State Audit Law and reporting of the summaries of annual audit reports by the State Audit of Vietnam have strengthened the process of external oversight. Under the World Bank's Poverty Reduction Support Operations and ADB's

²⁶ World Bank. 2009. *Program Document for a Proposed Credit in the Amount of \$350 million to the Socialist Republic of Viet Nam for an Eighth Poverty Reduction Support Operation*. Washington, D.C.

Support the Implementation of the Poverty Reduction Program III,²⁷ the government is working on improving governance in recruitment and promotion of civil servants, and development of an anticorruption strategy.

37. **Governance and anticorruption.** ADB's Anticorruption Policy (1998, as amended to date) was explained and discussed with the Government of Viet Nam and the executing agency. The government is taking an active approach against corruption, and recently adopted several legal changes, including the Anti-Corruption Law. Results of investigations against corruption overseen by the government inspectorate have been disclosed, and a legal framework established to protect and reward people who speak out against corruption.

B. Poverty and Social Impact Assessment

38. The financial sector plays a central role in the mobilization and allocation of resources in a modern market-based economy. Reforms supported under this and earlier programs have been integral to supporting Viet Nam's gradual transition to a market-based economy and to helping the government achieves and sustains high rates of economic growth. These, in turn, have been instrumental in the country's remarkable progress in poverty reduction over the last decade. The overall poverty rate dropped from 58% in 1993 to about 14.8% in 2008. According to government projections, the current poverty rate is below 10%. The impressive reduction in poverty is largely attributable to sustained business-led growth in investment, output, and employment that have been made possible partly by the financial sector reform programs. The private sector has created most of the new jobs in the last decade. The majority of private sector investment has come from domestic enterprises. The program's focus underscores the priority placed by the government in its national socioeconomic development plans and sector strategies on financial sector development.

C. Safeguards

39. The program does not trigger the safeguard policies and is rated as category C for environment, involuntary resettlement, and indigenous peoples.

D. Risks and Mitigating Measures

40. Subprogram 2 assumes political stability in the country and continued adoption of sound macroeconomic policies by the government. Given the track record of Viet Nam, both these assumptions are sound and defensible. Nonetheless, implementation of subprogram 2 is still subject to the risks described in the following table.

Summary of Risks and Mitigating Measures

Risks	Mitigating Measures
Exogenous, international financial shock, and macroeconomic instability	The government is undertaking measures to strengthen its monetary policy framework, expand the tax base, and strengthen public expenditure management, with the assistance of development partners including ADB.
Political resistance and vested interest may slow the reforms.	The government has shown strong commitment to the reform agenda. The government commitment is also manifested in the scope of legal and regulatory reforms implemented across the financial sector.
Poor governance and corruption	The government has increasingly adopted a tougher stance on corruption and recently taken measures including enacting the Anti-Corruption Law and setting up a steering committee against corruption.

²⁷ ADB. 2006. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Socialist Republic of Viet Nam for Support the Implementation of the Poverty Reduction Program III*. Manila (Loan 2262-VIE, approved on 5 October).

Risks	Mitigating Measures
Insufficient technical capacity of implementing agencies	The government's record and ADB's experience suggest these constraints are substantially ameliorated given adequate support and technical assistance.

ADB = Asian Development Bank.

Source: Asian Development Bank.

IV. ASSURANCES

41. The government and SBV have assured ADB that implementation of the program shall conform to all applicable ADB policies including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement as described in detail in the loan agreement. In addition to the continued compliance and implementation of the actions specified in the policy matrix and the standard assurances, the government has given the following specific assurances:

- (i) The government will ensure sustainability of the reform policies adopted and actions taken before the date of the loan agreement and described in the development policy letter (including the policy matrix).
- (ii) The government will keep ADB informed of, and the government and ADB will from time to time exchange views on, sector issues, policy reforms, and additional financial sector reforms that may be necessary or desirable, including progress made in carrying out policies and actions set out in the development policy letter, the PPPF, and related TA projects.
- (iii) The government will ensure that the counterpart funds will be used to support financial sector reforms to meet the financing costs associated with the program and the PPPF.

V. RECOMMENDATION

42. I am satisfied that the proposed loan will comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the loan in various currencies equivalent to SDR38,271,000 to the Socialist Republic of Viet Nam for subprogram 2 of the Third Financial Sector Program, from ADB's Special Funds resources, with an interest charge at the rate of 1.0% per annum during the grace period and 1.5% per annum thereafter; for a term of 24 years, including a grace period of 8 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan agreement presented to the Board.

Haruhiko Kuroda
President

5 November 2010

DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets and Indicators	Data Sources and Reporting Mechanisms	Assumptions and Risks
Impact A deeper, more diversified, and resilient financial sector	<p>Increase in the M2-GDP ratio by about 8 percentage points by the end of 2013 (82% in 2005)</p> <p>Increase in share of non bank financial sector assets to total financial sector assets from 15% in 2005, 16% in 2009 to about 20% - 25% in 2013</p> <p>Maintain average solvency ratio for banks above the 8% minimum capital adequacy ratio by 2013</p>	<p>Reports and websites of SBV and MOF</p> <p>Websites and statistics published by MOF and SBV</p> <p>Website and report from SBV</p>	<p>Assumptions Political stability</p> <p>Sound macroeconomic policies</p> <p>Risk External environment deteriorates, increasing stress on fiscal policy</p>
Outcome Increased share of capital markets in financing domestic investment	<p>Increase in number of listed companies from 44 in 2005 to about 700 by 2011</p> <p>Increase in total value of Government bond outstanding from 10% of GDP in 2005 to about 20% of GDP in 2011</p> <p>Increase in market capitalization in combined HNX and HSX from 1.11% of GDP in 2005 to about 30% in 2011</p>	<p>Reports and statistics published by SSC, MOF and the Stock Exchanges</p> <p>SBV, MOF, and SSC reports</p> <p>Websites and reports from SSC and Stock Exchanges</p>	<p>Assumptions Effective coordination among relevant government agencies</p> <p>Improved economic growth</p> <p>Risks Regional or global financial shocks may impact Viet Nam's capital markets and affect investor confidence</p> <p>Slow down in global economic growth</p>
Outputs 1. Enhanced capital market liquidity through improved information disclosure	<p>The weighted average bid–ask spread for government bonds declines by about 5 basis points by end of 2010 from 22 basis points in 2007</p> <p>Transactions of shares of public listed companies with shares registered with VSD promptly reported to relevant stock exchanges from February 2009 onward</p> <p>Accounting standards upgraded through step-by-step alignment with international accounting standards from March 2010</p>	<p>MOF, SSC, HNX reports and websites</p> <p>SSC and Stock Exchanges website and annual reports</p> <p>Letter from MOF on timeline for alignment with international accounting standards</p> <p>Copy of the relevant regulations provided by MOF</p>	<p>Assumptions Continued nondiscriminatory tax treatment of capital markets</p> <p>Improved economic growth</p> <p>Risks Insufficient market liquidity prevails, lack of demand, and the government's policy on the tenor structure of bonds</p> <p>Vested interests and political opposition slow program implementation</p> <p>Political backlash against rapid reforms weakens government commitment to reform process</p> <p>Weak capacity of the implementing agencies</p> <p>Weak coordination among agencies to implement reforms</p>

Design Summary	Performance Targets and Indicators	Data Sources and Reporting Mechanisms	Assumptions and Risks
2. Strengthened institutional framework for securities issuance	Total value of equity issuances of public listed companies, by end of 2010 is about double that in 2005 (about \$360million in 2005)	MOF, HNX and SBV reports/statistics/websites	Vested interests undermine policy reforms being undertaken Assumption Continued financial reforms by the government and no major setback Risks Delay in implementing SSC Strategy 2020 and lack of interagency coordination in bond market development Adverse market condition
3. Enhanced legal and regulatory framework for investor and consumer protection and financial sector stability	Proportion of debt of 5-year and above maturity in total government debt increases by about 7 percentage points by end of 2010 from 23% in 2005 Increase in number of retail investors in the stock markets from 30,000 in 2005 to about 80,000 by end of 2010 Improve ranking in protecting investors based on Doing Business assessment - better ranking for 2010–2013 (175 in 2007 and 171 in 2009) By end of 2010, in both stock exchanges (i) trading volume is about double the volume in 2005 (115.6 million shares in 2005); and (ii) trading value is about double the value in 2005 (\$250 million in 2005)	MOF and SBV annual reports MOF statistics, SSC annual report Doing Business, World Bank Group report Annual reports and websites of MOF, SSC, state treasury report and HNX and HSE.	Assumption Continued economic progress and commitment of the government to enhance market transparency, investor protection, and financial stability Risk Negative perception by investors on the Vietnamese capital markets and poor assessment of investor protection by international benchmark markers
4. Improved human resource development and regional cooperation	Government approves Viet Nam's admission as an MMOU Annex B signatory by 2011 Increase number of staff trained by about 10% from 2010 to 2013 SBV Report on Human Resource Development Plan to 2015 and vision up to 2020	IOSCO website Report of the preliminary assessment of the training needs of the SBV staff SBV capacity building report and conformation letter to this effect	Assumptions Approval by the government for Viet Nam's admission as MMOU Annex B signatory and continued commitment to gradually align domestic standards with that of international best practices Continued focus of the government on human resource development for financial sector Risks Failure on the part of government to approve Viet Nam's admission to MMOU Annex B signatory by 2011 Budget reduction for staff training
Activities with Milestones A. Enhanced capital market liquidity through improved information disclosure A.1. Improved requirements for information disclosure of listed and nonlisted public companies by the issuance of new circular by MOF, by September 2010			Inputs Asian Development Bank (Asian Development Fund): \$60 million

Activities with Milestones

A.2. Gap assessments and implementation timeline on gradual adoption of applicable IAS completed by MOF by August 2010

A.3. Submission of draft Law on Independent Audit to the government by September 2010

A.4. VSD to complete pilot implementation of automatic synchronization of records by August 2010; VSD to agree to conduct risk assessment by December 2010

A.5. Stock exchange to be transformed into a limited liability company by March 2010

A.6. SSC to complete a feasibility study for an information technology plan by March 2010

A.7. SSC to complete strategic capital markets sector road map 2020 by August 2010

A.8. MOF to issue revised circular governing registration, deposit, clearing, and securities settlement by August 2010

B. Strengthened institutional framework for securities issuance

B.9. HNX to report on the performance of UpCOM market after 1 year of operation by August 2010

B.10. MOF to obtain approval of the government and the National Assembly on the new Law on Public Debt Management by March 2010 and establish a PDMO by September 2010

B.11. MOF to seek public consultation on a comprehensive draft overarching decree replacing Decree 141 on all issues in government bonds by September 2010

B.12. SBV to complete a review of risk assessment of the operation of the money market and open markets and agree on an implementable plan based on gaps identified in the study under ADB TA for Preparing the Financial Sector Development Program III by August 2010^a

B.13. MOF to initiate review of the regulation (decree) for the issuance of corporate bonds by August 2010

C. Enhanced legal and regulatory framework for investor and consumer protection and financial sector stability

C.14. SSC to amend the Securities Law including adequacy of enforcement powers for government approval by August 2010

C.15. SBV to submit the revised SBV Law and Credit Institutions Law to the National Assembly by June 2010

C.16. SBV to issue instructions to credit institutions to submit plan to raise minimum charter capital requirements to D3 trillion by the end of 2010, including submission of monthly compliance status of capital position by August 2010; and SBV to issue implementing circular on organization and operation of commercial banks including corporate governance standards by September 2010

C.17. SBV to issue circular on merger and acquisition of credit institutions and application of bankruptcy law and special control by SBV on credit institutions by September 2010; SBV to impose new solvency ratio for credit institutions by August 2010

C.18. SBV to undertake a mutual evaluation by APG on money laundering and to strengthen procedures to enhance AMLA supervision, by June 2010

C.19. MOF to submit to the government draft amendments to specific articles of the Law on Insurance Business by August 2010

D. Improved human resource development and regional cooperation

D. 20. MOF to submit to the Prime Minister for approval on Viet Nam's acceptance by IOSCO as an MMOU Annex B signatory by June 2010

D.21. SBV governor to issue instruction to develop human resource development plan to 2015 and vision up to 2020, and SBV to conduct preliminary skill gap assessment by August 2010

ADB = Asian Development Bank; AMLA = anti-money laundering; APG = Asia Pacific Group on Money Laundering; GDP = gross domestic product; HNX = Hanoi Stock Exchange; HSX = Ho Chi Minh City Stock Exchange; IAS = international accounting standards; IOSCO = International Organization of Securities Commissions; M2 = M+1 most savings accounts, money market accounts, retail money market mutual funds, and small denomination time deposits (certificates of deposit of under \$100,000); MMOU = multilateral memorandum of understanding; MOF = Ministry of Finance; PDMO = Public Debt Management Office; SBV = State Bank of Vietnam; SSC = State Securities Commission; VSD = Vietnam Securities Depository; TA = technical assistance; UpCOM = unlisted public companies.

^aADB. 2005. *Technical Assistance to the Socialist Republic of Viet Nam for Preparing the Financial Sector Development Program III*. Manila (TA 4732-VIE, approved on 13 December).

Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/RRPs/?id=37577-02-3>

1. Loan Agreement
2. Sector Assessment (Summary): Finance
3. Contribution to the ADB Results Framework
4. Development Coordination
5. Country Economic Indicators
6. International Monetary Fund Assessment Letter
7. Summary Poverty Reduction and Social Strategy
8. Risk Assessment and Risk Management Plan
9. List of Ineligible Items

Supplementary Documents

10. Summary Program Impact Assessment
11. Justification for the Refinement of some of the Original Indicative Actions for Subprogram 2

DEVELOPMENT POLICY LETTER



STATE BANK OF VIETNAM

Office : 47 - 49 Ly Thai To, Hanoi
Tel : (84-4) 8242.479 Fax : (84-4) 8268.765

DEVELOPMENT POLICY LETTER

Mr. Haruhiko Kuroda
President
Asian Development Bank
Manila, Philippines

Hanoi, 13th October 2010

Dear Mr. President

Viet Nam Third Financial Sector Program Loan – Subprogram 2

1 Let me thank you for the continuing support of the Asian Development Bank and your own keen interest in promoting the development of resilient regional markets, including those in Vietnam. The Government appreciates the role of Asian Development Bank (ADB) as a development partner in promoting financial sector reforms in the past and in continuing to help articulate a vision of a modern, broad-based financial sector for Viet Nam.

2 **Government Commitment to Reforms.** This Letter of Development Policy highlights the Government of Viet Nam's commitment to sustain strong employment growth to further reduce poverty and improve living standards in Viet Nam. This commitment and actions to achieve it is highlighted in the country's results based Socio-Economic Development Plan (SEDP 2006- 2010). The Government has just completed a mid-term review of plan implementation which concluded that we are on target to realize and/or exceed most targets. We have now started the consultation process to formulate a Socio-Economic Development Strategy (2011-2020) and a SEDP 2011-15. While the details of these strategies are still being finalized, the focus will continue to be on poverty reduction and raising incomes and living standards by generating increased, and more productive, employment. Ongoing dialogue with ADB and other development partners is valuable in helping national stakeholders to develop strategies and actions to build on recent achievements, while also ensuring the realization of social and environmental goals. Recent experiences in Viet Nam and elsewhere in the region highlight the significance of having a well developed and efficient financial sector to mobilize the levels of investment needed for sustained achievement of high economic growth rates, continued progress on poverty reduction and facilitate market competitiveness. This remains the overarching Government priority.

3. **ADB support to Government's key reform initiatives.** FSPL III SP 2 will support government's key reform priorities with the objective of creating a more diversified, deeper, and more resilient financial sector in Viet Nam, aimed to address core issues including the need for more developed legal and regulatory framework and institutional capacities over the medium and long term. It is fully aligned with the Government's SEDP and congruent with the ADB's Country Strategy and Program for 2007-2010 which support business-led pro-poor growth through promoting infrastructure development, creating a business-enabling environment and a

2

diversified financial intermediation. The reform priorities include the need to strengthen alternative channels for market-based financial intermediation and to promote the development of non-bank financial sector. The FSPL III SP 2 program will make an important contribution to this process.

4. **Single Tranche Loan.** The Government will also wish to have the proposed SP 2 as a single tranche loan of \$60,000,000 equivalent from ADB's Special Funds resources covering the March 2009 September 2010 period. The Government stands committed to pursue the medium-term reform agenda beyond the Program towards meeting the overall objectives of the FSPL III SP 2. We look forward to ADB's continuous engagement and support over the medium-term in implementing the reforms.

5. **The Global Crisis and Recent Economic Performance.** Prior to global financial crisis in 2008, Viet Nam's economy recorded a speedy growth with an average GDP growth rate of 7.5% per annum for period of 2001-2005, and at about 8% per annum in the years 2006-2007. The GDP growth rate dropped to 6.2% and 5.3% respectively during the global financial crisis 2008-2009. The savings rate however, has been maintained at a relatively high level of over 30% of GDP and continues to increase since 2004 from 35% to 40% of GDP. The period of 2006-2009 had been challenging in terms of conducting monetary policy, including interest rate policy, exchange rates, sustainable economic growth and stable social security.

6. **Challenging Response.** Despite a period of challenging time, the country coped relatively well with the external shocks as witnessed by the GDP growth rate of 5.3% for the whole of 2009. Inflation was also kept under control when CPI reached 6.5% in 2009 (from as high as 22.97% in 2008) and appeared to be moderate in the first nine months of 2010 although there were concerns about potential CPI acceleration. There has been less pressure on the exchange rates in recent months as current account deficits have been less severe. The momentum has been maintained for the first nine months of 2010, and GDP growth is forecasted to increase to 6.5% largely attributed to increase in domestic investment. Industrial output grew 13.8% for the first nine months of 2010, with most sectors performing well.

7. The State Bank of Viet Nam (SBV) resorted to tightening the monetary policy in 2009-2010 due to inflationary pressures, but it is expected to move cautiously to ensure that a lack of available financing will not undermine the economic growth of the country. Although SBV has removed the cap on commercial bank lending rates, for which, such rates had been capped at 1.5 times the prime rate, the Government has recently called for rates to be reduced to spur credit growth. The removal of the interest rate cap has resulted in immediate increases in commercial lending rates about 2-3 percentage points; however, inflation has reduced to single digit.

8. **The FSPL III SP 2.** We appreciate that the SP 2 Program also acknowledged the difficult environment faced by Viet Nam in the wake of global financial crisis during the 2008-2009 periods, and recognized a number of significant key measures initiated by SBV in 2009-2010 in mitigating the impacts of the crisis to the financial sector to ensure financial stability. These measures include various micro-prudential requirements to increase charter capital of the banks together with their monthly monitoring of the banks' progress in their planned recapitalizations to strengthen the banking sector. Failure of the banks to increase their charter capital by December 2010 may result in banking consolidation. The SBV Law and the Credit Institutions Law has been amended and the banks have been brought under the Bankruptcy Law. To this end, the Program has been reformulated based on four key considerations. First, there has been a significant shift in Government policy for the financial sector in light of the international financial crisis. Second, there is increased recognition by the Government of the need to create the institutional basis for holistic and integrated reforms of the Government's debt

based reforms of short term money markets operations in order to provide the basis for a secondary market in Government securities. Fourth, the refined program recognized lessons learned under FSPL2 notably that finance sector reforms in transitional economies often recognize a clearly defined step-by-step approach over the medium-to-long term as new institutions and concepts need to be introduced and related capacity built. In addition, it is important to note that while the objectives for securities markets development falling under the purview of the Ministry of Finance faced significant difficulties as a result of the turmoil and loss in market capitalization arising from the global financial crisis, a vigorous policy response has provided a long-term vision and strategy for the modernization of this sector. This is incorporated into the refined program.

9. To lay the foundation of a deeper, more diversified and resilient financial sector, the Government recognizes the need for (i) enhancing capital market liquidity, (ii) strengthening institutional framework for securities issuance, (iii) strengthening financial sector stability and consumer protection, and (iv) promoting regional cooperation and human resource development

1. Output 1: Enhanced Capital Market Liquidity through Improved Information Disclosure

10. Both mandated and voluntary disclosures are expected to convey material information to the market through significant and high stock market reactions around earnings disclosures. Consequently, they reduce information asymmetries among informed and uninformed market participants and enhance market liquidity. SP 2 supports a new core policy action covering the new regulation issued by MOF that requires information disclosure of both listed and unlisted public companies moving a step closer to adopting international best practices. Under a new core policy action SSC has completed a comprehensive analysis of a Strategic Development for the Vietnamese Capital Markets for 2010-2020 to address market infrastructure bottlenecks to capital market growth. As a step towards converging the Vietnamese accounting standards with that of international standards, a Circular has been issued to guide the application of international accounting standards on presentation of financial statements and disclosure of financial instrument

11. In order to enhance market information standards, as originally envisaged, the draft Law on Independent Audit has been submitted to the Government for approval. To enhance information disclosure, the Viet Nam Securities Depository (VSD) has completed the pilot implementation of automatic synchronization of records between its head office and branch with full implementation of book-entry based system for public companies registered with VSD.

2. Output 2: Strengthened Institutional Framework for Securities Issuance

12. To support the development of the Government securities market, the program supports legal and institutional reforms aimed at establishment and operationalization of the PDMO for a uniform management of Government and national debts. This is a core policy measures that the Government has prioritized in response to the global financial crisis in 2008. Together with the Banking and Financial Institutions Department of MOF, the Office will provide an institutional focal point to support a range of key reforms in this area, including lengthening Government securities issuance calendar, the need for having primary dealers system, and credit rating agency in the future as indicated in the milestones. MOF has conducted a comprehensive review of the existing Decree 141/2003/ND-CP which covers all issues relating to the Government bonds, Government-Guaranteed Bonds and Municipal Bonds to support the development of Government bond market. The Government also aims to develop the corporate bond market by a revision of Decree 52/2006/ND-CP. This is expected to contribute further improvement to the issuance procedures and liquidity in the bond markets. To improve the risk management and operational efficiency of money market and open market operations for liquid

4

management and operational efficiency of money market and open market operations for liquid secondary market, SBV has agreed to initiate the implementable short-term risk mitigation measures identified in the ADB TA Report¹ by August 2010.

3. Output 3: Enhanced Legal and Regulatory Framework for Investor and Consumer Protection and Financial Sector Stability

13. The Program supports review of legal framework for the Securities Law with a view to strengthening enforcement powers and investor protection. Likewise, amendments of the Law on Insurance Business have been submitted to the Government for consideration.

14. The State Bank of Viet Nam as part of its response to the global financial crisis and with support under SP 2 has introduced various micro-prudential measures to strengthen the commercial banks including the submission of a draft law on credit institutions to the National Assembly, the adoption of corporate governance requirements for commercial banks based on the corporate governance principles of the Organization of Economic Cooperation and Development (OECD), measures to strengthen the banks' capital base with further increase in charter capital to be met by end of December 2010, amendments to SBV Law, a Decree on the application of Bankruptcy Law on credit institutions including special control by SBV in an effort to drive banking consolidation.

15. As part of its efforts to strengthen its anti-money laundering regime, Viet Nam has joined the Asia Pacific Group on Money Laundering (APG) and was subject to the evaluation by the APG in July 2009. This is considered a positive step and complements the milestone for supervisory authorities to develop and implement procedures and strengthen capacity for effective supervision of AML regulations. A new core policy action supported under SP2 is the submission of the draft amendments to the insurance law to the Government by August 2010 and the issuance of a decree on administrative penalties for insurance business.

4. Output 4: Improved Regional Cooperation and Human Resource Development

16. Viet Nam has implemented measures to further improve information exchange and cooperation with other securities regulators. One of the conditions stipulated in SP 1 is for SSC to conduct an assessment of its ability to meet benchmarks under the IOSCO Multilateral Memorandum of Understanding (MMOU) and to develop a roadmap for it to become a signatory to Annex B of the IOSCO MMOU by filling out the evaluation form required by IOSCO. The reformulated policy action for SP 2 requires MOF to submit to the Government for consideration and approval for Viet Nam to become a member of the MMOU Annex B Signatory. This has been accomplished. Viet Nam has been accepted as an IOSCO MMOU Annex B signatory which is subject to the Government's approval. SP 2 supports a systematic approach to capacity building for financial sector development. SBV is developing a 5-year human resource development plan to 2015 and a vision up to 2010. In line with this move, SBV will conduct a skill gap assessment to formulate a comprehensive capacity building for its resources.

Postprogram partnership framework

17. In line with the Government's reform agenda for development of the financial sector through FSPL III SP 2, the Government is committed to an ongoing policy reform program to be implemented over April 2011 to 2013. It is recognized that the monitoring framework focuses on

¹ ADB. 2010. *Review and Assessment of the Risks of the Operations of Central Banking Department of State Bank of Vietnam*. Manila. (TA 4732-VIE, consultant's report).

the government's medium-term plan advancing its reforms in strengthening regulatory coordination and enhancing investor protection, increasing market efficiency, liquidity, and transparency, strengthening market infrastructure and intermediaries, and developing new products and expanding investor base through enhanced education and improved risk management. SP 2 also includes a PPPF with high impact policy actions and institutional development measures building on reforms and core actions under SP 2 which will serve as a platform for further engagement with the Government as indicated in the Appendix 3 (policy matrix). We understand that the PPPF is subject to further refinements to reflect the Government's priority in response to changing market environment.

18. **Conclusion.** FSPL III SP 2 provides us with a framework of medium-term reforms and implementation support, and the Government is committed to undertake the policy actions under SP II of the FSPL III. Following the completion of the SP 2, the Government and ADB will review progress and the prevailing environment to decide further reforms based on achievements and lessons learned from implementing the FSPL III SP 2. The Government is confident it can implement the reform agenda for SP 2 and achieve the program objectives. The Government will collaborate closely with ADB in implementing the proposed reforms to facilitate the process to ensure it conforms to the requirements of the program. Successful implementation of the FSPL II SP 2 will contribute to our shared objective of developing a stronger, more diversified and resilient financial sector, and increase contributions of capital markets that can contribute to sustaining Viet Nam's economic growth in the future. We are resolved to working with ADB towards a successful outcome of the program.

19. The Government has agreed with ADB on certain conditions of the Program, which are set forth in the loan agreement. The Government highly appreciates the support of ADB in formulating and implementing this program. ✓

Yours sincerely,



NGUYỄN VĂN GIÀU

POLICY MATRIX AND POST-PROGRAM PARTNERSHIP FRAMEWORK

No.	Reformulated/ New Core Actions	Status of Accomplishment	Post-Program Partnership Framework (PPPF) (2011-2013)
A. Enhanced Capital Market Liquidity Through Improved Information Disclosure			
A.1	MOF to issue a Circular on disclosure of information in securities market applicable to listed and unlisted public companies (NCA)	<u>Accomplished</u> <u>Agency: MOF</u> <u>Compliance documents:</u> (i) MOF Circular Number 9/2010/TT-BTC dated 15/01/2010.	MOF to undertake a review of the implementation of Circular number 9/2010/TT-BTC dated 15/01/2010. to enhance information disclosure in securities market.
A.2	MOF to initiate the gap assessment for applicable accounting standards to align the Vietnamese accounting standards closer to the International Accounting Standards. (RCA)	<u>Accomplished</u> <u>Agency: MOF</u> <u>Compliance documents:</u> (i) MOF Circular Number 210/2009/TT-BTC dated 6 November 2009 to guide the application of international accounting standards on presentation of financial statements and disclosure of financial instruments. (ii) Confirmation letter from MOF on initiating the gap assessment study for applicable accounting standards against the international standards including a broad timeline for implementation of recommendations.	MOF to enhance capacity building for skilled resources and capability in the accounting area
A.3	MOF to submit to the Government the draft Law on Independent Audit. (RCA)	<u>Accomplished</u> <u>Agency: MOF</u> <u>Compliance document:</u> (i) Letter number 62/TT-BTC from MOF	MOF on behalf of the Government to submit the draft law on Independent Audit to the Standing Committee of the National Assembly.

No.	Reformulated/ New Core Actions	Status of Accomplishment	Post-Program Partnership Framework (PPPF) (2011-2013)
		dated 14 May 2010 submitting the draft law to the Government, (ii) Draft Law on Independent audit	Upon approval of the law on Independent Audit by the National Assembly, MOF to develop capacity to implement the law.
A.4	VSD to complete the pilot implementation of automatic synchronization of records between its Head Office and the HCMC branch with full implementation of book-entry based system for public companies which are centrally registered with VSD. (RM)	<u>Accomplished</u> <u>Agency: VSD</u> <u>Compliance documents:</u> Report dated 30 August 2010 from VSD to MOF on the completion of this action.	VSD to conduct a study on its risk management which is benchmarked against international best practices. This study will also recommend the nature and scope of a new risk management function within VSD, or an appropriate model for the consideration of the VSD Board.
A.5	Enhance corporate governance of Stock Exchanges (SEs) by transforming HNX into a limited liability company. (RM)	<u>Accomplished.</u> <u>Agency: MOF</u> <u>Compliance documents:</u> (i) HNX was transformed into a limited liability company in 2009 in accordance with the Decision 01/2009/QD-TTg dated 2 January 2009 by the Prime Minister. (ii) Copy of the Decision (Gazette) - available on the Government website.	Hanoi Stock Exchange to ensure adherence to Decision number 01/2009/QD-TTg.
A.6	Draft feasibility study on building an IT system to supervise the securities industry. (RM)	<u>Accomplished</u> <u>Agency: SSC</u> <u>Compliance document:</u> (i) The draft feasibility study by SSC on the disclosure system which is part of	

No.	Reformulated/ New Core Actions	Status of Accomplishment	Post-Program Partnership Framework (PPPF) (2011-2013)
		the IT plan.	
A.7	SSC to formulate the Viet Nam Securities Market Development Strategy for the period 2010-2020 for submission to MOF. (NCA)	<u>Accomplished</u> <u>Agency: SSC</u> <u>Compliance documents:</u> Draft Securities Market Development Strategy for the period 2010-2020.	SSC to formulate a Plan on human resource development for securities sector, to strengthen the training activities and to raise public awareness on securities market, including utilization of the SSC website to provide information to the public.
A.8	<u>New core action</u> MOF to issue a Circular revising the regulation of registration, deposit, clearing and securities settlement to enable SSC to issue guidelines for the timing of subsequent securities' sales after an original trade. (NCA)	<u>Accomplished</u> <u>Agency: MOF</u> <u>Compliance document:</u> MOF Circular Number 43/2010/TT-BTC dated 25 March 2010.	SSC to develop and issue, subject to MOF approval, appropriate guidelines for the timing of subsequent securities' sales after an original trade.
A.9	HNX to report on the performance of the UpCOM market after one year of operation, from June 2009 to June 2010. (NCA)	<u>Accomplished</u> <u>Agency: HNX</u> <u>Compliance document:</u> HNX progress Report on the performance of the UpCOM market after one year of operation, from June 2009 to June 2010.	
B. Strengthened Institutional Framework for Securities Issuance			
B.10	(i) The law on Public Debt Management	<u>Accomplished</u> <u>Agency: MOF</u> <u>Compliance documents:</u> (i) The Law on Public Debt Management	

No.	Reformulated/ New Core Actions	Status of Accomplishment	Post-Program Partnership Framework (PPPF) (2011-2013)
	<p>to be approved by the National Assembly.</p> <p>(ii) The Government to establish PDMO with appropriate mandate.</p> <p>(NCA)</p>	<p>(which was approved on 17 June 2009) and took effect on 1 January 2010).</p> <p>(ii) MOF Decision No 1168/QD-BTC dated 22 May 2009 on the functions, tasks, responsibilities and organizational structure of the Debt Management and External Finance Department (PDMO).</p>	
B.11	<p>MOF to seek public consultation on the comprehensive draft Decree replacing Decree 141/2003/ND-CP which covers all issues relating to the Government bonds, Government-guaranteed bonds and municipal bonds.</p>	<p><u>Accomplished</u> <u>Agency: MOF</u></p> <p><u>Compliance documents:</u></p> <p>(i) Draft Decree to replace Decree 141/2003/ND-CP (ii) Status Report number 106/TTDT-NVCM on public consultation dated 15 March 2010</p>	<p>MOF to formulate a road map for the implementation of actions under the Bond Market Development to 2020.</p>
B.12	<p>(i) SBV to complete a review and assessment of the risks in areas of central banking operations, including money market and open market operations and to agree stage one (i.e. short term measures) of an implementation plan (covering short-term, medium-term and long term) based on the gaps identified in the study.</p> <p>(NCA)</p>	<p><u>Accomplished</u> <u>Agency: SBV</u></p> <p><u>Compliance documents:</u></p> <p>(i) TA 4732 VIE Report: Review and assessment of the risks of the operations of Central Banking Department of the State Bank of Viet Nam – November 2009/January 2010. (ii) Correspondence between ADB and SBV on agreed TORs and documentary evidence on appointment of experts to provide support with implementable short-term risk mitigation measures.</p>	<p>SBV to effectively implement the short term action plans developed by SBV and based on the TA 4732 VIE Report, to be phased in during the next three years.</p>

No.	Reformulated/ New Core Actions	Status of Accomplishment	Post-Program Partnership Framework (PPPF) (2011-2013)
B.13	MOF to review the regulatory regime (Decree 52/2006/ND-CP) for the issuance of corporate bonds to further develop the corporate bond market. (RM)	<u>Accomplished</u> <u>Agency: MOF</u> <u>Compliance document:</u> Draft Decree to replace Decree 52/2006/ND-CP – this will be the comprehensive “umbrella” for the corporate bond market.	MOF to finalize and submit the draft Decree to the Government.
C. Enhanced Legal and Regulatory Framework for Investor and Consumer Protection and Financial Sector Stability			
C.14	MOF to submit to the Government the draft Law on Amendment To Some Articles of the Securities Law, including enhancing the adequacy of enforcement powers (C)	<u>Accomplished</u> <u>Agency: SSC</u> <u>Compliance document:</u> (i) Submission letter No 90/TTr-BTC dated 15 July 2010 by MOF to the Government (ii) The draft Law On Amendment To Some Articles of the Securities Law.	SSC to enhance its supervisory and enforcement capacity to enforce the securities law.
C.15	SBV Law and Credit Institutions Law to be approved by the National Assembly. (NCA)	<u>Accomplished</u> <u>Agency: SBV</u> <u>Compliance documents:</u> (i) Law on State Bank of Viet Nam No. 46/2010/QH12 on 16/06/2010 (ii) Law on Credit Institution No. 47/2010/QH12 on 16/06/2010	SBV to implement a system of reviewing legal documents and drafting of guidelines for the implementation of the SBV Law and Credit Institutions Law which have been passed by the National Assembly.
C.16	(i) SBV to issue instructions to credit institutions to submit a plan to raise minimum charter capital requirements by end-2010.	<u>Accomplished</u> <u>Agency: SBV</u> <u>Compliance documents:</u> (i) Letter 397 for credit institutions dated	SBV to initiate actions on banks that have failed to increase minimum charter capital by end of December 2010 with appropriate process.

No.	Reformulated/ New Core Actions	Status of Accomplishment	Post-Program Partnership Framework (PPPF) (2011-2013)
	<p>(NCA)</p> <p>(ii) SBV to issue instructions to credit institutions to submit monthly status with respect to adequacy of meeting the charter capital requirements.</p> <p>(iii) SBV to issue implementing circular on organization and operations of commercial bank.</p>	<p>14 January 2010; (ii) Letter 398 for SBV local branches to monitor the enforcement by credit institutions dated 14 January 2010).</p> <p><u>Accomplished</u> <u>Agency: SBV</u></p> <p><u>Compliance documents:</u></p> <p>Document number 3417/NHNN-TTGSNH and 3418/NHNN-TTGSNH issued by SBV on 10/05/2010 directing credit institutions and branches of SBV in provinces and cities to implement and report on the increased capital of credit institutions according to Decree No. 141.</p> <p><u>Accomplished</u> <u>Agency: SBV</u></p> <p><u>Compliance documents:</u></p> <p>(i) Decree 59 Decree 59/2009/Nd-CP dated 16 July 2009 (ii) Circular 06 issued by SBV</p>	
C.17	<p>(i) SBV to issue the circular providing for: (a) merger and acquisition of credit institutions; (b) the application of bankruptcy to credit institutions; (c) direct control of defaulting credit institutions by SBV; and (d) licensing requirements for joint-stock banks.</p>	<p><u>Accomplished</u> <u>Agency: SBV</u></p> <p><u>Compliance documents:</u></p> <p>(i) SBV Circular 4 dated 11 Feb 2010 on mergers and acquisitions of financial institutions (ii) Bankruptcy Decree 05/2010/ND-CP of 18 January 2010</p>	<p>SBV to initiate banking consolidation exercise for banks that fail to meet with the new charter capital requirements by 31 December 2010.</p>

No.	Reformulated/ New Core Actions	Status of Accomplishment	Post-Program Partnership Framework (PPPF) (2011-2013)
	<p>(ii) SBV to enhance the prudential and solvency ratio of credit institutions by issuance of a new circular – this includes requirement to increase the capital adequacy ratio (CAR) from 8% to 9% and other prudential measures.</p> <p>(NCA)</p>	<p>(iii) Circular 08 dated 22 March 2010 on Special Control over Credit Institutions (iv) Circular 09 dated 26 March 2010 on requirements to incorporate a domestic joint stock commercial bank (prior to granting a license by SBV)</p> <p><u>Accomplished</u> <u>Agency: SBV</u></p> <p><u>Compliance documents:</u> Circular number 13/2010/TT-NHNN dated 20 May 2010.</p>	
C.18	<p>SBV to undertake a mutual evaluation with the Asia Pacific Group (APG) on Money Laundering and to introduce measures to strengthen the procedures and capacity for effective supervision of AML requirements.</p> <p>(RCA)</p>	<p><u>Accomplished</u> <u>Agency: SBV/ AMLD Supervisory Agency</u></p> <p><u>Compliance documents:</u></p> <p>(i) APG Evaluation Report dated July 2009 (ii) Circular 22/2009/TT-NHNN dated 17/11/2009 providing guidance on anti-money laundering measures (iii) Decision 470/QD-TTG dated 13 April 2009 on the establishment of National Committee for Anti-Money Laundering (iv) Draft procedures for AML component for on-site inspections for credit institutions (v) Assessment of implementation of Decree 74</p>	<p>SBV to submit to the competent authority level in order to upgrade a Decree 74 /2005/ND-CP dated 7 June 2005, into an Anti Money Laundering Law and to build an effective legal implementation plan of anti money laundering measures for financial institutions.</p>

No.	Reformulated/ New Core Actions	Status of Accomplishment	Post-Program Partnership Framework (PPPF) (2011-2013)
C.19	<p>(i) MOF to submit to the Government the draft Law on Amendments To Some Articles of the Law on Insurance Business.</p> <p>(ii) The Government to issue the Decree on administrative penalties for insurance businesses.</p> <p>(NCA)</p>	<p><u>Accomplished</u> <u>Agency: MOF</u></p> <p><u>Compliance documents:</u></p> <p>(i) The draft Law on Amendments To Some Articles of the Law on Insurance Business (which was submitted to the Government in June 2010).</p> <p>(ii) Letter (number 76/TTr-BTC) from MOF dated 17 June 2010 submitting the draft law to the Government.</p> <p><u>Accomplished</u> <u>Agency: MOF</u></p> <p><u>Compliance documents:</u> Decree 41/2009/ND-CP dated 5 May 2009.</p>	<p>MOF to develop capacity to implement the said Law, upon approval, and Decree 41/2009/ND-CP.</p>
D. Improved Regional Cooperation and Human Resource Development			
D.20	<p>MOF to submit to the Prime Minister for approval for Viet Nam to become a MMOU Annex B Signatory, following admission approval by IOSCO.</p> <p>(RCA)</p>	<p><u>Accomplished:</u> <u>Agency: MOF</u></p> <p><u>Compliance documents:</u> (i) Confirmation letter from MOF on its submission to the Prime Minister.</p>	<p>SSC to undertake an assessment of the implementation of the IOSCO principles after the IOSCO has completed revision of its principles</p>
D. 21	<p>(i) SBV Governor to issue a directive for SBV to formulate human resource development plan to 2015 and a vision up to 2020.</p> <p>(ii) SBV to conduct assessment on the training needs to serve as a basis for a</p>	<p><u>Accomplished</u> <u>Agency: SBV</u></p> <p><u>Compliance documents:</u> (i) A letter from Personnel Department of SBV confirm plan.</p> <p><u>Accomplished.</u></p>	<p>Based on the skill gaps assessment result, SBV to implement two separate training programs to enhance staff skills and capacity for the (i) banking supervisors, and (ii) policy-makers.</p>

No.	Reformulated/ New Core Actions	Status of Accomplishment	Post-Program Partnership Framework (PPPF) (2011-2013)
	comprehensive Outline of the Human Resource Development Plan to 2015 and vision to 2020. (NM)	<u>Agency: SBV</u> <u>Compliance documents:</u> Report on the assessment of the training needs of SBV staff.	

C = Core Action, M = Milestone, NCA = New Core Action, RCA = Reformulated Core Action.
Source: Asian Development Bank.