ADB

Report and Recommendation of the President to the Board of Directors

Project Number: 44251-034
November 2015

Proposed Policy-Based Loan for Subprogram 2 Socialist Republic of Viet Nam: Financial Sector Deepening Program

Asian Development Bank

CURRENCY EQUIVALENTS

(as of 4 November 2015)

Currency unit	–	dong (D)
D1.00	=	$0.0000448
$1.00	=	D22,318

ABBREVIATIONS

ADB	–	Asian Development Bank
ASEAN	–	Association of Southeast Asian Nations
GDP	–	gross domestic product
HNX	–	Ha Noi Stock Exchange
MMDWG	–	Money Market Development Working Group
MOF	–	Ministry of Finance
NPL	–	nonperforming loan
PFM	–	public financial management
SBV	–	State Bank of Viet Nam
SDR	–	special drawing right
SEDS	–	Socio-Economic Development Strategy 2011–2020
SOE	–	state-owned enterprise
SSC	–	State Securities Commission
TA	–	technical assistance
VAMC	–	Viet Nam Asset Management Company

GLOSSARY

Association of Southeast Asian Nations	–	A political and economic organization of 10 Southeast Asian countries, which was formed on 8 August 1967. Membership includes; Brunei Darussalam, Cambodia, Indonesia, the Lao People's Democratic Republic, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Viet Nam.
benchmark issue	–	A highly liquid bond that provides a price standard against which the performance of bonds of other maturities or credit quality are measured. Government bonds are almost always used as benchmark bonds, which in turn form the basis of a yield curve.
fragmentation	–	A situation wherein an excessive number of financial instruments spread trading activity across each instrument such that trading levels in any one instrument are diminished.
money market	–	A subsection of the fixed-income market that specializes in very short-term debt securities (debt that matures in less than 1 year). Money market securities are essentially unsecured obligations to pay issued by governments, financial institutions, and large corporations.

nonperforming loan	–	A sum of borrowed money upon which the debtor has not made his or her scheduled payments for at least 90 days. A nonperforming loan is either in default or close to being in default. Once a loan is nonperforming, the odds that it will be repaid in full are considered to be substantially lower. This definition is almost universally recognized by bank regulators across the globe.
yield curve	–	A yield curve is a term structure of interests which derives from bonds with equal credit quality but differing maturity dates. The most well-known is the U.S treasury yield curve which has points at various maturities including; 3-months, 2-years, 5-years, 10-years, and 30-years. This yield curve is used as a benchmark for pricing all other debts in the market, such as mortgage rates or bank lending rates. The curve is also used to predict changes in economic output and growth.

NOTE

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

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PROGRAM AT A GLANCE

1. Basic Data

Project Number: 44251-034

Project Name	Financial Sector Deepening Program Subprogram 2	**Department /Division**	SERD/SEPF
Country	Viet Nam, Socialist Republic of	**Executing Agency**	State Bank of Vietnam
Borrower	Socialist Republic of Viet Nam		

2. Sector

Sector	Subsector(s)	ADB Financing ($ million)
✓ **Finance**	Banking systems and nonbank financial institutions	25.00
	Finance sector development	50.00
	Money and capital markets	25.00
	Total	**100.00**

3. Strategic Agenda

Strategic Agenda	Subcomponents
Inclusive economic growth (IEG)	Pillar 1: Economic opportunities, including jobs, created and expanded
Regional integration (RCI)	Pillar 3: Money and finance

Climate Change Information

Climate Change impact on the Project	Low

4. Drivers of Change

Drivers of Change	Components
Governance and capacity development (GCD)	Institutional development Public financial governance
Knowledge solutions (KNS)	Knowledge sharing activities
Partnerships (PAR)	Implementation Private Sector
Private sector development (PSD)	Conducive policy and institutional environment Public sector goods and services essential for private sector development

Gender Equity and Mainstreaming

No gender elements (NGE)	✓

5. Poverty Targeting

Project directly targets poverty	No

Location Impact

Nation-wide	High

6. Risk Categorization: Complex

7. Safeguard Categorization

Environment: C **Involuntary Resettlement:** C **Indigenous Peoples:** C

8. Financing

Modality and Sources	Amount ($ million)
ADB	**100.00**
Sovereign Program loan: Asian Development Fund	100.00
Cofinancing	**0.00**
None	0.00
Counterpart	**0.00**
None	0.00
Total	**100.00**

9. Effective Development Cooperation

Use of country procurement systems	Yes
Use of country public financial management systems	Yes

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed policy-based loan to the Socialist Republic of Viet Nam for subprogram 2 of the Financial Sector Deepening Program.[1]

2. The Socio-Economic Development Strategy (SEDS), 2011–2020 is designed to help Viet Nam transition into a modern, productive, and equitable market-based economy. In particular, the government seeks to increase the role of the nonbank finance sector and deepen the financial markets in Viet Nam to sustain the financing of productive investment. Subprogram 2 continues and deepens the reforms begun under subprogram 1. It will support the development of a well-functioning money market and a deeper and more liquid capital market, and improve the capacity of public and private institutions in the finance sector.[2]

II. THE PROGRAM

A. Rationale

3. **The development problem.** The government aspires to reach middle-income country status, with a per capita income of at least $3,000 and significant improvements in human development and poverty reduction by 2020. However, this goal is being challenged as structural factors impede higher economic growth—the average annual growth rate fell from 7.8% during 2004–2007 to 5.6% in 2010–2014— over the medium to long term. In particular, the finance sector is shallow and does not support the efficient intermediation of funds into productive investments. As the figure on the following page shows, Viet Nam's finance sector is dominated by bank credit much more than those of its regional peers Indonesia and the Philippines, which is partly explained by state-owned commercial banks' lending to state-owned enterprises (SOEs). The nonbank finance sector, which represents an alternative source of intermediation of corporate credit needs, remains in a nascent state of development. The money market and government bond market, fundamental building blocks of a capital market, are underdeveloped.[3] The corporate bond market and the equities market are also among the smallest and least developed in Southeast Asia, suggesting a capital market that cannot fully support Viet Nam's longer-term economic growth and development. Further, the finance sector's nascent state of development means that policy levers necessary to maintain macroeconomic stability are also limited generally to administrative measures and fiscal policy.

4. **Development constraints**. The government has recognized these challenges and has identified a set of key problems that must be overcome to ensure the financial sector can provide increasing levels of intermediation. These key problems are: (i) a small and illiquid money market, (ii) heightened systemic risk and a shallow bond market, and (iii) inadequate financial infrastructure and capacity.

5. The money market is small, exhibits limited activity, and is defined by instruments with very short tenors. Heightened credit risk in the banking sector and a lack of transparency has

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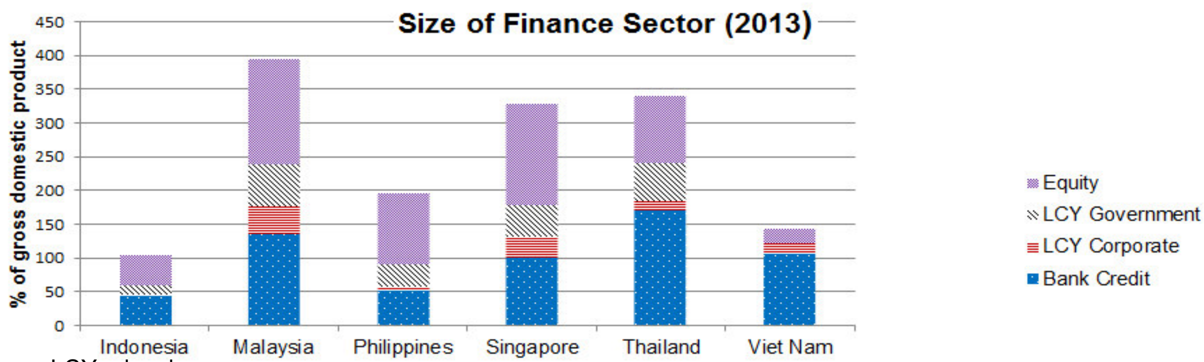
[1] The programmatic approach and subprogram 1 was approved in 2013. See: ADB. 2013. *Report and Recommendation of the President to the Board of Directors for the Programmatic Approach and Policy-Based Loan (Subprogram 1) to the Socialist Republic of Viet Nam for the Financial Sector Deepening Program.* Manila.

[2] The design and monitoring framework is in Appendix 1.

[3] A well-functioning money market enables (i) financial institutions to match short-term assets and liabilities, (ii) security dealers to finance their inventories and to maintain two-way markets, (iii) corporations to manage working capital needs, (iv) the central bank to conduct more effective monetary policy, and (v) the market to price financial instruments based on short-term benchmark rates.

also fragmented the market. This situation has been exacerbated by a lack of standardized agreements, such as repurchase agreements, which serve to reduce risks. While recent reforms have increased the volume of interbank lending, more needs to be done to build coordination across stakeholders, including the government, to ensure that reliable, market-driven, short-term benchmark interest rates are established and maintained.



LCY = local currency
Source: AsianBondsOnline

6. The banking sector is weak. The government recognizes that the banking sector's high levels of nonperforming loans (NPLs) and undercapitalization serve as a fundamental drag on capital market development and limit credit availability. The most recent International Monetary Fund Article 4 Consultation, dated October 2014, estimated aggregate NPLs in the banking industry at just over 4% of total loans.[4] However, private sector sources routinely publish estimates that are much higher.[5] To date, reform of the banking sector has been constrained by its poor risk controls, weak identification of problem assets, an inability to dispose of problem assets in a robust and timely manner, and weaknesses in the regulatory regime to resolve problem banks.

7. The capital market is shallow and illiquid. As of 31 December 2014, the local currency bond market amounted to only 22% of gross domestic product (GDP), well below the overall average of 57.8% for emerging East Asia. The corporate bond market remains dormant. The government bond market typically provides a market-determined term structure of interest rates along a variety of maturity points, forming a yield curve. This term structure, or yield curve, is an essential building block without which a corporate, derivative, and structured finance market could not develop. In Viet Nam, the government bond market is concentrated in short-term maturities of less than 3 years, and exhibits limited liquidity. The Ministry of Finance (MOF) has strengthened the regulatory environment and extended tenors. However, more needs to be done to ensure that primary auctions of government bonds are preannounced and predictable. Trading volume must be increased by concentrating the government's bond issues into a broader but limited set of standardized maturities which include longer-term tenors. Fragmentation must be reduced and price transparency must be improved.

8. Parallel reforms will be necessary to ensure supporting financial infrastructure is conducive to market development. Upgrades to the government securities settlement system, which is currently dependent on a commercial bank, will reduce settlement risk and increase market confidence. The adoption of International Financial Reporting Standards will improve

[4] Figures provided by the State Bank of Viet Nam (SBV).
[5] In 2013, Fitch Ratings estimated system aggregate NPLs at 15% of total loans, with an 80% loss rate that would reduce system aggregate tier 1 capital to 1% from the 10% reported by the SBV.

transparency, increase confidence and provide much-needed incentives to strengthen risk management. In addition, a stronger commitment to capacity development will make sure that regulatory surveillance and oversight remain capable as the market matures.

9. **The government's reform agenda.** To restore higher economic growth and tackle longer-term macroeconomic challenges to stability, the government recognizes that it needs to pursue reforms to allocate its high national savings—31.2% of GDP in 2014—more efficiently and effectively toward productive investment. The recent Financial Sector Assessment Program has sharpened the government's resolve to increase financial stability as a necessary precondition for capital market development.[6] Efforts to reduce the large overhang of NPLs and to strengthen the banking system have gained momentum. As of the end of 2014, the Viet Nam Asset Management Company (VAMC) had purchased D123 trillion of NPLs from the banking subsector, although it's limited powers have resulted in minimal disposals. The government has accelerated the implementation of reforms under SEDS and initiated SOE restructuring to reduce the dominance of inefficient state production and to enhance economic growth. Within this framework, the government remains committed to finance sector development since it represents a key aspect of the reform agenda under the SEDS.[7] The equity and corporate bond markets represent essential sources of financing for recapitalizing the banking system, and for equitized SOEs. Market-sourced funding also provides much-needed discipline, which encourages competition, efficiency, and governance. Finally, reforms in these areas will strengthen the economy's resilience to shocks by mitigating risks posed by an overreliance on the bank-dominated finance sector, strengthening the implementation of monetary policy, and improving the overall allocation of resources within the economy.

10. **Asian Development Bank's contribution and lessons learned.** In recognition of these interrelationships, the Asian Development Bank (ADB) is continuing and strengthening its "whole of sector approach," which encompasses SOE reform, finance sector development, and an increase in the availability of credit. The second periodic financing request under the State-Owned Enterprises Reform and Corporate Governance Facilitation Program was approved on 16 December 2014.[8] This request provided funding support to three SOEs—Construction Corporation No. 1 Company Limited, Song Da Corporation, and Vietnam National Textile and Garment Corporation—to implement a comprehensive package of corporate and financial reforms. This initiative built on an earlier ADB engagement that developed an enabling environment, including the creation of a centralized government institution to formulate, coordinate, and lead the implementation of SOE reform. In addition, ADB has provided support to financial inclusion through subprogram 2 of the Microfinance Development Program approved by the ADB Board of Directors in December 2014.[9]

11. Broader finance sector development serves to boost the catalytic role that markets play in economic development. ADB has provided various finance sector program loans and technical assistance (TA) support since 1996, which helped Viet Nam as it transitions to a market-based financial system.[10] Initial efforts introduced the basic concepts and systems for banking, including a legal framework, negotiable instruments, and secured transactions. Next,

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[6] International Monetary Fund. 2014. *Viet Nam: Financial Sector Assessment*. Washington, DC.

[7] The Sector Road Map for the Strategic Development of the Vietnamese Capital Market covers 2011–2020.

[8] ADB. 2009. *Report and Recommendation of the President to the Board of Directors: Multitranche Financing Facility to the Socialist Republic of Viet Nam for the State-Owned Enterprises Reform and Corporate Governance Facilitation Program.* Manila.

[9] ADB. 2014. *Report and Recommendation of the President to the Board of Directors: Policy-Based Loan to the Socialist Republic of Viet Nam for the Microfinance Development Program (Subprogram 2).* Manila.

[10] ADB's Sector Program and Experience (accessible from the list of linked documents in Appendix 2).

ADB supported the introduction of competition to the banking industry and initiated the development of the nonbanking sector to increase market-based financial intermediation. The next stage focused on delivering four main outputs: increasing market liquidity and lowering transaction costs, establishing a public debt management office, strengthening investor and consumer protection, and operationalizing the country's Anti-Money-Laundering Information Center. These efforts were coordinated with and bolstered by other regional initiatives, such as the Asian Bond Market Development Initiative and the Asian Capital Markets Forum.[11]

12. These engagements provided useful lessons that were incorporated into the design of the program.[12] First, finance sector development is recognized as hierarchical and requires careful sequencing over a medium- to long-term gestation period. Key foundation reforms must be successfully implemented before moving on to more complex reforms. Also, ADB and the government now emphasize the achievement of mutually agreed quantitative performance indicators and tangible results. To ensure that tangible results are achieved, ADB and the government jointly identify and design policy measures that directly contribute to the achievement of performance indicators. Prior programmatic approaches tended to focus on the mere completion of policy actions which were often based on purely administrative accomplishments.

13. **ADB's value added to program design and implementation.** Key policy reforms under subprogram 1 (footnote 1), which was approved on 6 December 2013, include the establishment of formal coordination between the State Bank of Vietnam (SBV) and MOF. This coordination effort, e.g., the establishment of the Money Market Development Working Group (MMDWG), produced the money market development master plan and regulatory framework, which led to the emergence of a more robust money market under subprogram 2. In addition, MOF finalized the bond market development road map, a key pillar of the program; strengthened the legal framework governing the issuance and management of public debt; and increased the transparency of public debt auctions. Also, the government began, for the first time, to concentrate public debt into select, longer-tenor benchmark securities. MOF established a road map to adopt the International Financial Reporting Standards and launched an effort to establish a policyholder protection fund, both of which are being completed under subprogram 2. Finally, the government initiated a sustained effort to introduce corporate governance reforms by participation in the Association of Southeast Asian Nations (ASEAN) Corporate Governance scorecard, and established a comprehensive plan for capacity development.

14. The reforms implemented under subprogram 1 have produced tangible results. Viet Nam's total local currency bonds outstanding grew 43.1% year-on-year to reach D866 trillion ($38.0 billion) as of the end of December 2014. In fact, Viet Nam was the fastest-growing local currency bond market in emerging East Asia in the fourth quarter of 2014 (quarter-on-quarter and year-on-year). Policy reforms also galvanized the money market, where average quarterly interbank lending turnover increased from the 2010 baseline of D1.2 trillion to D74.4 trillion in 2014. Nonbank financing expanded as local currency bonds increased from 16% of GDP in 2010 to 22% in 2014 (2015 target: 25%)[13] while total outstanding government bonds held by the contractual savings industry increased from 11% in 2010 to 14% in 2014 (2015 target: 16%). The average maturity of the government securities portfolio was extended by the continuing issuance of longer tenors.[14] The stock market exhibits similarly promising trends—its combined

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[11] ADB. 2010. *Technical Assistance for Promoting an Interlinked ASEAN Capital Market*. Manila (TA 7576-REG).
[12] ADB. 2014. *Completion Report: Third Financial Sector Program in Viet Nam.* Manila.
[13] This target was an indicator for program impact in subprogram 1.
[14] The number of auctions of 10- and 15-year government bonds has more than doubled since 2013; the aggregate face amount of 10-year notes rose from D8 billion to D33 billion, and 15-year notes from D4 billion to D15 billion.

capitalization increased from 19% of GDP in 2010 to 30% as of 2014 (2015 target: 35%). Overall market liquidity also improved. Government bond turnover increased from less than 1.0x in 2010 to 2.5x in 2014, while the aggregate value traded across the Ha Noi Stock Exchange (HNX) and Ho Chi Minh Stock Exchange increased from D180 trillion in 2010 to D732 trillion in 2014 (2015 target: +25%).

15. ADB has also provided direct support to the completion of reforms under subprogram 2. An ADB-funded resident advisor utilized surveys, research notes, and policy recommendations to develop the broad stakeholder consensus necessary to drive development of the money market. Building on this consensus, policy dialogue has led to greater coordination between stakeholders in the money market, which has further increased its depth and activity. ADB helped the government identify reforms to the legal framework, which are needed to reduce operational risk in the money market, and supported the development of a plan to transfer the cash settlement leg of government securities transactions to the SBV. Responding to recent requests, policy advice was provided to VAMC regarding disposal of problem assets, and ADB supported MOF in further refining and implementing the bond market development road map. ADB is supporting ongoing efforts to adopt international standards, and in particular, International Financial Reporting Standards. Frequent consultations between major donors, including the Government of Canada and the World Bank, provide for consistency of advice and a comprehensive reform program.[15]

16. **Policy-based loan and budget support.** ADB will continue its programmatic support to increase the role of the nonbank finance sector in financing productive investment. This approach utilizes policy-based lending in conjunction with extensive policy dialogue in recognition of the long-term time horizon required for finance sector development and the need to sequence reforms. Subprogram 2 includes three primary outputs: (i) a well-functioning money market, (ii) a deeper and more liquid capital market, and (iii) capacity of public and private institutions in the finance sector improved. In addition, subprogram 2 contains significant additional reforms, not originally contemplated in subprogram 1, which build a sound foundation to begin reducing systemic risk levels as well as the large stock of NPLs in the banking sector. Demonstrating this long-term commitment to finance sector reforms, the government has also requested from ADB follow-on programmatic support from 2017 to 2021, which will combine finance sector development with financial inclusion.

17. **Economic impact.** The program's expected economic impact includes cost savings arising primarily from a reduction in the cost of the government's debt thanks to a drop in the risk premium. Compliance with international standards, including Basel II (para. 25), will yield further benefits.

B. Impact and Outcome

18. The program is aligned with the SEDS and will increase the role of the nonbank finance sector in financing economic activities by deepening the financial markets in Viet Nam. The outcome remains the same—strengthened investor confidence. At the inception of the programmatic approach in 2013, the government agreed to 45 indicative policy actions as a basis for subprogram 2. ADB confirmed that 38 of these indicative actions were accomplished.[16] At the request of the government, ADB agreed to sharpen the focus of subprogram 2, and future programs, by concentrating on key reforms. Through this process, 33 indicative actions were

[15] Development Coordination (accessible from the list of linked documents in Appendix 2).
[16] Of the balance, four were deferred to align sequencing and are covered by the post program partnership framework, and three were dropped due to a lack or relevance, or because they were overtaken by other reforms.

combined into 22 high-impact policy actions and three new policy actions were added to recognize the government's efforts to strengthen the banking sector and thereby reduce systemic risks. Subprogram 2 now contains 25 reform actions (9 triggers representing mandatory high impact reforms and 16 milestones), which the government completed between September 2013 and June 2015.[17] Four completed actions were dropped from the program as no follow up actions would be required, and one was dropped because a lack of data prevents additional reforms.

C. Outputs

20. **Output 1: A well-functioning money market.** The output builds on accomplishments under subprogram 1 to develop a money market by strengthening coordination and promoting trading activity. To implement increasing complex reforms, the SBV and MOF now participate in a formal interministerial coordination group.[18] In addition, the SBV has restructured the activities and responsibilities of the MMDWG to better align the mandates of the members and the objectives of the MMDWG. The SBV encouraged greater activity in the short-term money market through its liquidity management operations by regularly issuing SBV bills with tenors of 28 days, 56 days, 91 days, and 182 days. This activity has provided provisional short-term benchmark rates at 30 days, 60 days, 90 days, and 180 days. In addition, SBV encouraged increased activity in the money market by strengthening bank prudential liquidity standards, as well as expectations of risk management with higher penalties for noncompliance.[19] As normalized liquidity operations resumed in the banking industry, the SBV increased transparency by introducing real-time trade monitoring and post-trade reporting for foreign exchange interbank transactions.[20] Domestic interbank rates and volumes are now published on the SBV's website, subject to a 3-day delay, and a working group was established to launch real-time trade monitoring and reporting for domestic interbank transactions modeled on the Reuters platform utilized for the foreign exchange interbank market.

21. **Output 2: A deeper and more liquid capital market**. Output 2 builds on efforts to develop a capital market by introducing new measures to reduce systemic risk, and by continuing reforms to develop the bond market and improve oversight and transparency. In particular, financial stability is a necessary precondition for capital market development (footnote 5). A formal monitoring group was established to track and ensure the implementation of priority recommendations arising from the recently completed Financial Sector Assessment Program, such as reducing systemic credit risk and resolving NPLs. To accelerate the resolution of NPLs, the government increased VAMC's capital to $100 million equivalent. Utilizing recently requested access to development partners, including ADB, the government established a foundation for NPL resolution by authorizing VAMC to issue its own debt to purchase NPLs at market value, and strengthened its NPL resolution powers to allow asset sales without the consent of the borrower or originating bank. In parallel, the SBV increased capital in the banking system by progressively adopting the Basel II standards for large domestic banks. The SBV required implementation of the standardized approach by the end of 2015 and targeted adoption of the complex internal ratings-based foundation approach by the end of 2018. Concurrently, the

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[17] Reconciliation of the original Subprogram 2 to the revised Subprogram 2 (accessible from the list of linked documents in Appendix 2).
[18] The wider coordination group will now provide a venue through which monetary policy can be better coordinated and short-term benchmarks can be set independently of the SBV's liquidity operations.
[19] These standards were modeled on Basel III.
[20] Participants use a standard trading platform for foreign exchange provided by Thomson Reuters Dealing.

SBV improved the identification of NPLs, and implemented an enhanced problem bank resolution regime backed by the revised bankruptcy law.[21]

22. Continuing reforms begun in subprogram 1, the government introduced a basic framework to accelerate development of the bond market. To improve the operation of the primary and secondary government debt market, MOF identified specific government bonds that will serve as short-term and long-term benchmarks. Within this framework, MOF was able to reduce fragmentation—the total number of government bond issues declined from 270 in 2010 to 117 as of the end of 2014—and extend the average maturity of the government debt portfolio by continuing the regular issuance of 10- and 15-year tenors. The government developed a framework to launch a primary dealer system composed of "bidding members", identified their basic rights and obligations, and established an annual review and ranking of the participants. To increase transparency and price discovery, HNX now publishes quarterly and annual debt auction schedules on its website, and utilizes indicative prices to build a government bond yield curve. Complementary reforms were also enacted to strengthen the government's supervisory powers and increase transparency. To deepen international links and cooperation, the State Securities Commission (SSC) became a signatory to the International Organization of Securities Commissions' Annex A.

23. **Output 3: Capacity of public and private institutions in the finance sector improved**. Continuing from subprogram 1, the output strengthens financial market infrastructure and institutional capacity. MOF completed a draft Law on Accounting for presentation to the National Assembly which will progressively align the Vietnamese Accounting Standards with International Financial Reporting Standards, including the concept of market or "fair" value.[22] To reduce systemic risk in the securities settlement process, MOF—through SSC, the Viet Nam Securities Depository, and the SBV—established a steering committee and working group that will transfer the cash settlement leg of government bond transactions from a commercial bank to the SBV and develop a limited-purpose central clearing counterparty to support the introduction of derivatives trading. In accordance with the Law on Insurance Business, MOF established, funded, and staffed a policyholder protection fund and instituted a supporting governance framework. Reforms to build the public equity markets and to increase trading volumes and efficiencies continue. SSC completed an action plan for merging HNX and Ho Chi Minh Stock Exchange.[23] MOF, through SSC, published corporate governance rankings of publicly listed companies by group, using the ASEAN Corporate Governance Scorecard, and completed a draft plan to establish an institute of directors to advocate and support reforms to corporate governance. Finally, the government continued to strengthen the capacity of line institutions responsible for finance sector development and supervision. On the debt side, MOF now completes independent assessments of Viet Nam's debt sustainability. The SBV implemented its human resource development (training) plan, through which 4,789 participants completed a structured regime of soft skills, general professional skills, and select advanced technical skills.

D. Development Financing Needs

24. The government has requested a loan equivalent to $100,000,000 from the Asian Development Fund to help finance the program. The loan will have a 25-year term, including a grace period of 5 years, an interest rate of 2% per annum during the grace period and thereafter, and such other terms and conditions as are set forth in the draft loan agreement. The

[21] By 25 April 2014, the SBV has directly acquired two failed commercial banks at a price of D0 per share, effectively extinguishing shareholder rights.
[22] This law is expected to be approved by the General Assembly in late 2015 or early 2016.
[23] The plan has been submitted to MOF and the Prime Minister for review and approval.

loan proceeds will be used to finance the full foreign exchange cost (excluding local taxes and duties) of items produced and procured in ADB member countries, excluding ineligible items and imports listed in the negative list attached to the loan agreement. The proceeds of the policy-based loan will be disbursed in accordance with the provisions of ADB's Simplification of Disbursement Procedures and Related Requirements for Program Loans.[24]

25. In 2015, the government will need to borrow D171 trillion to cover a budget deficit targeted at 4.1% of GDP. In 2014, deficit financing was obtained from domestic sources (44%) and external sources (56%), of which some 84% was accounted for by official development assistance. Assuming a similar distribution, the government will borrow an estimated $3.8 billion through official development assistance to close the budget gap. The size of the loan primarily reflects the government financing needs, the strength of the reform program, and, secondarily, the costs of implementation (para. 25).[25]

E. Implementation Arrangements

26. Subprogram 2 covers September 2013–June 2015. The executing agency is the SBV; the implementing agencies are the MOF, SSC, HNX, and SBV. The MMDWG acts as a coordination mechanism for the implementation of the money market development master plan. In addition, subprogram 2 contains measures that serve to broaden coordination of capital market development between the SBV and the MOF, and across other government agencies.

III. DUE DILIGENCE

A. Economic and Financial

27. A growing body of empirical research produces a remarkably consistent narrative—the services provided by the financial system exert a first-order impact on long-run economic growth.[26] On a program-specific level, a program impact assessment was prepared to estimate the potential benefits and costs of subprogram 2 using a cost–benefit analysis framework.[27] The net benefits are expected to approximate $246 million. The benefits arise from economic gains arising primarily from an assumed 20-basis-point reduction in the risk premium on Viet Nam's government debt. The costs of subprogram 2 include costs to the Government of Viet Nam associated with issuing debt of longer tenors ($3.2 million) and increasing the capital of the VAMC ($75 million). Costs also accrue to the private sector, such as those associated with adopting Basel II requirements and other reporting and information disclosure requirements stemming from the reforms.

B. Governance

28. The government undertook and finalized the first Public Expenditure Financial Accountability assessment in July 2013. It confirmed that the government has a functioning public financial management (PFM) system capable of efficiently collecting a substantial amount of revenues as a proportion of GDP. Challenges included a lack of alignment between investment plans and budgets. The system of targeted transfers to local government units

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[24] ADB. 1998. *Simplification of Disbursement Procedures and Related Requirements for Program Loans*. Manila.
[25] ADB. 2013. Policy-Based Lending. *Operations Manual. OM D4/BP.* Manila (para. 32).
[26] R. Levine and S. Zervos. 1998. Stock Markets, Banks, and Economic Growth. The American Economic Review; and M. Arena. 2008. Does Insurance Market Activity Promote Economic Growth? A Cross-Country Study for Industrialized and Developing Countries. The Journal of Risk and Insurance,
[27] Program Impact Assessment (accessible from the list of linked documents in Appendix 2).

needs to be reoriented from an input-driven approach to one driven by performance, and capacity is a persistent issue. Further, the government is pursuing a progressive agenda for reforms.[28] ADB has supported these efforts since 2008 with initiatives to improve planning, strengthen PFM, and increase legal transparency and accessibility.[29] For example, the government adopted several legal reforms, including the Anti-Corruption Law. Under the National External Debt and Public Debt Strategy, 2011–2020, aggregate public debt information was published for the first time.[30] The National Assembly recently approved amendments to the 2002 Budget Law to deepen the implementation of the medium-term expenditure framework and performance-based budgeting, and to improve budget execution, monitoring, and implementation. These revisions, expected to be ratified in 2015 and effective in 2017, will also enhance budget transparency and disclosure. ADB is preparing small-scale TA to assist the government in implementing components of the new budget law. Tax management and customs modernization reforms are under way, increasing the transparency of administrative procedures and reducing compliance costs for taxpayers. The government's SOE reform program also helps improve PFM through its divestment and equitization program, which is being supported by ADB. ADB's Anticorruption Policy (1998, as amended to date) was explained to the government and SBV.

C. Poverty and Social

29. Viet Nam has achieved remarkable progress in reducing poverty during 1993–2008: GDP per capita rose by an average 6.1% annually and poverty fell 2.9 percentage points each year to below 10% by 2010.[31] These reductions are largely attributable to sustained business-led growth in output and employment, complemented by targeted poverty reduction interventions. According to the United Nations Development Programme, Viet Nam is likely to achieve most of its Millennium Development Goals by 2015. Recent upgrades to Viet Nam's monitoring systems to incorporate current expenditure patterns allow for improved pro-poor spending programs in future. Returning Viet Nam to high and sustained economic growth, a primary driver in poverty reduction, will require macroeconomic stability along with structural reforms, such as the restructuring of poorly performing SOEs, recapitalization and strengthening of the banking industry, and the development of a more efficient capital market.

30. Within the framework of the SEDS, the government has embarked on an ambitious goal of restructuring SOEs, reducing the large overhang of NPLs, and eliminating bottlenecks that impede growth in the capital market. The Sector Road Map for the Strategic Development of the Vietnamese Capital Market, which is part of the SEDS, serves as a master plan for long-term capital market development. The program is aligned with the road map and aims to strengthen the legal, regulatory, and institutional frameworks and market infrastructure to sustain the financing of productive investment. The government has requested from ADB a follow-on programmatic approach that combines finance sector development and financial inclusion to support greater coverage and usage of financial services by the poor.[32]

[28] Public Financial Management Assessment (accessible from the list of linked documents in Appendix 2).
[29] ADB. 2008. *Report and Recommendation of the President to the Board of Directors: Proposed Program Loan to the Socialist Republic of Viet Nam for the Implementation of Poverty Reduction Program Cluster V*. Manila.
[30] Government of Viet Nam. 2012. *National External Debt and Public Debt Strategy*, 2011–2020. Ha Noi.
[31] World Bank. 2012. *Well Begun, Not Yet Done: Vietnam's Remarkable Progress on Poverty Reduction and the Emerging Challenges*. Washington, DC.
[32] Summary Poverty Reduction and Social Strategy (accessible from the list of linked documents in Appendix 2).

D. Safeguards

31. Subprogram 2 will not entail any involuntary resettlement or negatively affect indigenous people or the environment. It is classified C in all safeguards categories.

E. Risks and Mitigating Measures

32. Subprogram 2 is exposed to high levels of broad national and macroeconomic risks, and risks associated with PFM and corruption. High inflation and fiscal risk have their roots in structural issues, while structural reform itself poses high fiscal risks. Risks arising from PFM include budget weaknesses and lack of an effective audit oversight. Procurement has been hampered by decentralization, capacity constraints, and conflicts of interest. Anticorruption mechanisms are not yet fully effective. Recent improvements in macroeconomic performance serve to mitigate macroeconomic risks, as detailed in a recent macroeconomic and debt sustainability assessment.[33] Otherwise, ADB is coordinating with other development partners to mitigate risks and is providing TA to improve PFM. ADB is also engaging the government through anticorruption dialogue and will evaluate support for the Construction Sector Transparency Initiative to bolster anticorruption efforts. Overall, program-specific risks are medium and include a possible decline in political will to implement technically difficult reforms, protracted or inadequate efforts to advance SOE reform and bank recapitalization, and a lack of funding for capacity development. However, the government's explicit resolve to implement key reforms recommended in the Financial Sector Assessment Program, as well as the policy goals of the SEDS, provide evidence of its increasing commitment to reform. Under an ongoing project, ADB is supporting the government's priority efforts to reform SOEs, and to strengthen its problem bank and NPL resolution schemes. Active donor support and provisional plans by ADB to fund capacity development provide additional risk mitigation. Specific risks and corresponding mitigating measures are described in detail in the risk assessment and risk management plan.[34]

IV. ASSURANCES

33. The government and the SBV have assured ADB that implementation of subprogram 2 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 documents.

V. RECOMMENDATION

34. I am satisfied that the proposed loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and, acting in the absence of the President, under the provisions of Article 35.1 of the Articles of Agreement of ADB, I recommend that the Board approve the loan in various currencies equivalent to SDR 71,413,000 to the Socialist Republic of Viet Nam for subprogram 2 of the Financial Sector Deepening Program, from ADB's Special Funds resources, with an interest charge at the rate of 2% per annum during the grace period and thereafter; for a term of 25 years, including a grace period of 5 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.

Stephen Groff
Vice-President

4 November 2015

[33] Macroeconomic and Debt Sustainability Assessment (accessible from the list of linked documents in Appendix 2).
[34] Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

DESIGN AND MONITORING FRAMEWORK

The Program is aligned with the Socio-Economic Development Strategy, 2011–2020 and will increase the role of the nonbank finance sector in financing economic activities by deepening the financial markets in Viet Nam.[a]

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
Outcome Strengthened investor confidence	**By 2015** Rank and score of Pillar 6: Financial Markets improves by 2015[b] (2010 baseline: 50/1.4)	World Economic Forum Financial Development Report (annual)	Political will for finance sector reforms wanes. Government does not carry out state-owned enterprise reform and bank recapitalization in a timely manner.
Outputs 1. A well-functioning money market	**By 2015** 1a. Increase in available tenors of Treasury bills and/or SBV bills and/or repurchase agreements. (2010 baseline: 2 tenors available; 182 days and 364 days)	1a. SBV website market surveys	Coordination between the SBV and MOF is not adequate, resulting in conflicting application of policy and disruptions in the bond market.
	1b. GMRA adopted and launched (2010 baseline: not adopted)	1b. SBV website Consultant reports[c]	Adequate funding is not provided to support sustained capacity development efforts.
	1c. Aggregate quarterly turnover in the interbank market increased (Q3 2010 baseline: D1,244 trillion)	1c. SBV website Reuters	Supply and demand for interbank borrowing is adversely affected by external factors. The legal framework contains significant impediments that would delay or prevent adoption of GMRA.
2. A deeper and more liquid capital market	**By 2015** 2a. Volume of government bonds held by contractual savings sector increases to 16%[c] (2010 baseline: 11%)	2a. MOF	
	2b. Average tenor of government bonds (excluding Treasury bills) increases to 4–6 years[c] (2010 baseline: 3.8 years)	2b. MOF website AsianBondsOnline	
	2c. Increase in bond trading volume to 0.25% of outstanding listed bonds[c] (2010 baseline: 0.2%)	2c. MOF website AsianBondsOnline	

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
	2d. Aggregate value of stock traded on HNX and HOSE increases by 15% (2010 baseline = D180 trillion)	2d. HOSE and HNX website	
3. Capacity of public and private institutions in the financial sector improved	**By 2015** 3a. Vietnamese Accounting Standards more than 50% aligned to International Financial Reporting Standards (Baseline = 0) 3b. At least 50% of the Insurance Supervisory Agency supervision staff trained on examination and inspection 3c. Comprehensive skills gap assessment completed 3d. Capacity development under the medium-term training plan 50% completed	3a. Consultant reports[c], MOF website 3b.Consultant reports[c], MOF website 3c. SBV Human Resources Department 3d. SBV Human Resources Department	
Key Activities with Milestones Not applicable			
Inputs Asian Development Bank: $100,000,000 equivalent			
Assumptions for Partner Financing Not applicable			

GMRA = Global Master Repurchase Agreement, HOSE = Ho Chi Minh Stock Exchange, HNX = Ha Noi Stock Exchange, MOF = Ministry of Finance, Q = quarter, SBV = State Bank of Viet Nam.

[a] Government of Viet Nam. 2010. *Socio-Economic Development Strategy, 2011–202*0. Ha Noi.

[b] Pillar 6 captures foreign exchange and derivatives markets, as well as equity and bond market development.

[c] These performance targets are extrapolated midpoints from MOF's targets, which cover 2011–2020. The source is the Asian Development Bank. MOF's bond market development targets represent performance goals, but are not considered firm commitments of the government.

[d] Asian Development Bank. 2014. *Technical Assistance to the Socialist Republic of Viet Nam for Strengthening Financial Markets*. Manila.

Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS
http://adb.org/Documents/RRPs/?id=44251-034-3

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. Macroeconomic and Debt Sustainability Assessment
11. Program Impact Assessment
12. Public Financial Management Assessment
13. ADB's Sector Program and Experience
14. Reconciliation of the Original Subprogram 2 to the Revised Subprogram 2

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DEVELOPMENT POLICY LETTER

Hanoi, 05th September 2015

Letter of Development Policy from the Socialist Republic of Vietnam
Financial Sector Deepening Program

Dear Mr. President,

1. We would like to express our appreciation for the continuing support of the Asian Development Bank and your own keen interest in the promotion of more resilient regional markets, including those in Vietnam. We believe ADB's support through the Financial Sector Deepening Program (FSDP), and related technical assistance, has been instrumental in off-setting the effects of an ongoing slowdown in Asian economies caused by a confluence of events including the weakened European economy, rebalancing in the Chinese economy, and the imminent increase in interest rates in the United States. To this end, we recognize the need to continue strengthening government policies to credibly prioritize stability and address weaknesses in the financial sector.

2. As you are well aware, Viet Nam has achieved rapid economic growth over the past two decades by continuously implementing market-oriented reforms. With average annual growth rates of 6.6% from 2007 to 2011, followed by 5.2% in 2012 and 5.4% in 2014, Viet Nam's gross domestic product per capita rose from $843 in 2007 to $1,910 in 2013. The country is now classified as a lower middle-income country. Its development has benefited from political and social stability. Viet Nam has weathered global macroeconomic instability well, posting an average growth rate higher than regional comparator countries. Viet Nam has also addressed the symptoms of macroeconomic problems by tightening monetary and fiscal policies, lowering inflation from a peak of 23% in August 2011 to single digits from May 2012 to the end of 2013. While the process has been effective, the government acknowledges that the growth impetus unleashed by early reforms is losing some momentum, requiring that reforms deepen and accelerate.

3. To provide a renewed momentum for reform, Vietnam's Socio-Economic Development Strategy 2011–2020(SEDS) established a roadmap to transform Vietnam into a modernity-oriented industrial country with a per capita income level of US$3,000 (in current U.S. dollars) by 2020. The Socio-Economic Development Strategy also identifies the country's key priorities to meet this ambitious target: stabilize the economy, build world-class infrastructure, create a skilled labor force, and strengthen market-based institutions. Within the Socio-Economic Development Plan, the initiatives of the second of two 5-year plans, which covers 2016-2020, requires our urgent attention. These goals include the restructuring the economy together with renovating our growth model towards high quality, efficiency and competitiveness. Efforts to restructure the economy will focus on three important fields: investment, especially public investment; financial market, especially commercial banking system and financial institutions; and enterprises, in particular economic groups, and state-owned corporations. A strategic focus and specific actions are recommended for each sector while crosscutting issues center on strong reform and good governance.

4. In recognition of the challenges ahead, we look forward to planning our next Country Partnership Strategy (CPS 2016-2020)with ADB to establish our mutual commitment to supporting inclusive growth, enhancing economic efficiency, and providing for environmental sustainability. Continuing development of the finance sector will remain among the six priority sectors as the Government recognizes that financial sector development is essential in ensuring private sector led growth and economic development. Entering the second decade of 21st century, Viet Nam is at a critical juncture and needs to sustain its development progress to ensure that it can move to a higher income status and continue to reduce poverty. Compared to low-income developing countries on the one hand, and high-income developed countries on the other, middle-income emerging market economies are the most vulnerable to financial crises and instability. Continuous financial sector reforms are therefore viewed as essential, as Viet Nam is migrating towards a higher middle income status and a more productive, innovative, and mature market-based economy.

5. Therefore, on behalf of the Government, I would first like to reconfirm Vietnam's continuing commitment to reforming the financial sector. As a visible demonstration of this commitment, Vietnam has established a program to address the priority recommendations of our first Financial Sector Assessment Program (FSAP) by the International Monetary Fund and World Bank.. In addition, the Government has redoubled its efforts to expand and further deepen the financial sector..Bond and insurance markets have been established but they are still not proportional to their potentials. In particular, the Government will focus on improving the confidence of investors, consumers, and the general public to ensure that potential investors, both domestic and offshore, are reassured about the stability of the market and the regulatory environment into which their investments will be placed.

6. In supporting financial sector development, the Government retains its focus on the need to build short-term money markets. Vibrant and liquid money markets are vital funding mechanisms for financial institutions and contribute to market efficiency and discipline. Under Subprogram 1 of FSDP, the government has completed a number of key milestones towards that objective. A Money Market Development Working Group was established to guide and coordinate implementation of the Money Market Development Master Plan. Subsequently, the working group issued guidelines to provide a legal framework to support the negotiation of valuable papers, including repurchase contracts, between credit institutions. Prudential regulations covering the liquidity management practices of credit institutions have also been substantially upgraded.. Moreover, the Government launched an effort to identify the impediments to introducing repo market based on international standards.

7. The Ministry of Finance (MOF) has concurrently strengthened the issuance and management of public debt under Subprogram 1 and has refined its mechanism to issue government bonds, including auction timing and announcements, mechanisms for issuing government bonds, and the allowable uses and levels of sovereign guarantees. To support the development of the domestic corporate bond market, MOF rationalized and streamlined regulations governing issuance and administrative procedures, while at the same time increasing the responsibility and accountability of the issuers. More broadly, MOF has strengthened the standards for information disclosure and transparency in the securities market. MOF has implemented the Law on Independent Audit by drafting decrees to strengthen the accounting and auditing industry. MOF, through SSC has strengthened corporate governance standards of publically listed companies by adopting the ASEAN Corporate Governance scorecard. At the same time, the Hanoi Stock Exchange strengthened its own internal corporate governance by issuing and implementing a code of conduct for staff.

8. Finally, Subprogram 1 of FSDP strengthened the capacity of public institutions to achieve the full benefit of our ongoing structural reforms. The SBV and MOF completed human resource development (training) plans covering the period 2011-2020. The Ministry of Finance initiated a program to build expertise and in time, to publish an in-house debt sustainability analysis. More significantly, the Government recognized the need to introduce market value into Vietnam Accounting Standards to provide the appropriate incentives for the next step of financial market reforms. As a first step, the Ministry of Finance completed a full gap assessment of International Accounting Standards as compared to Vietnam Accounting Standards to support eventual alignment of the two, including the introduction of market value.

9. These actions have already begun to produce positive results. The SBV and MOF are more closely coordinating their activities to deepen the short-term yield curve. SBV is issuing bills across a wider range of short-term tenors, creating a usable, if only temporary short-term yield curve. MOF now requires its 1-year treasury bills to trade across the Hanoi Stock Exchange and trading volume has increased to VND 17,614.3 billion in 2014 from VND 11,973.2 billion in 2013. Overall, the size of the local currency bond market has more than doubled over the last seven years, rising to 22% of Gross Domestic Product as of 31 December 2014.In fact, Viet Nam was the fastest growing LCY bond market in emerging East Asia (EEA) in the fourth quarter of 2014 (7.1% quarter-on-quarter and 42.1% year-on-year).This represents an accelerated expansion from the 15.6% year-on-year increase recorded through December 2013.

10. To continue these reforms, we are requesting the Asian Development Bank's favorable consideration on the proposed Subprogram 2 of FSDP. This proposed Subprogram 2 will support the Government's reform agenda over the period September 2013to June 2015 including the continuing implementation of the Money Market Development Master Plan. In addition, Subprogram 2 will support the continuing development of the domestic bond market through the bond market development roadmap (2011 to 2020). Through the implementation of this roadmap, the Ministry of Finance plans to increase outstanding bonds to 38% of GDP in 2020 from 14% in 2011, with government bonds increasing to 22% of GDP, Government guaranteed bonds increasing to 8%of GDP, corporate bonds increasing to 7% of GDP and municipal bonds increasing to 1% of GDP.

11. Specifically, under Subprogram 2, the Government will improve the enabling environment, and increase support to the development of the money market by increasing the level of coordination between major stakeholders, strengthening the underlying framework, and improving information disclosure and transparency. Specifically reforms will start by enhancing and deepening inter-agency coordination in the execution and management of macroeconomic policy (including monetary). The Ministry of Planning and Investment, the Ministry of Industry and Trade, MOF and SBV have signed an Inter-ministerial Regulation on coordination which will lead to a more coordinated effort to encourage the development of a short-term money market. In addition, the Government has restructured the membership, activities and responsibilities of the working group to ensure appropriate participation and expertise. In conjunction with liquidity management operations and existing coordination agreements, SBV is conducting a regular issuance of SBV bills with tenors of 28 days, 56 days, 91 days, and 182 days. This activity, along with the publication of 1 and 2 week, as well as 1, 3, 6, and 9 month domestic interbank rates and volumes is providing a nascent short-term yield curve with benchmarks at 30, 60, 90 and 180 days. At the same time, SBV has continued to strengthen liquidity management in the banking sector by adopting standards, modeled on Basel 3, which include a dynamic short term cover ratio, a static structural ratio, and requirements for risk management.SBV has initiated real-time trade monitoring and post-trade reporting for interbank foreign exchange transactions,

authorized the introduction of derivatives based on listed stocks, stock indices, and government bonds, and has completed a legal survey which indicates minimal risk of re-characterization of repo transactions, and the acceptability of equivalent and margin securities.

12. To build investor confidence, and to reduce systemic risk, the Government is addressing priority recommendations of the FSAP with SBV coordinating across agencies. As part of this effort, SBV has increased the minimum capitalization through the adoption of Basel 2 for large domestic banks. Risk management has been strengthened by regulations designed to improve the identification and reporting of NPL's, while SBV's supervisory capacity has been enhanced through the adoption of a problem bank resolution regime backed by the revised bankruptcy law. Finally, the Government has drafted a revised legal and regulatory framework to increase VAMC's capitalization and enhance its NPL resolution powers.

13. Efforts to build a domestic bond market will continue under Subprogram 2 by rationalizing and further modernizing the primary and secondary government bond market and introducing complementary reforms to strengthen the legal and regulatory framework. Specifically, the Government has introduced a primary dealer system composed of "bidding members" with specified basic rights and obligations, along with an annual review and ranking of the participants. Concurrently, the Government prepared a revised framework to identify short-term and long-term benchmarks, provide for switch auctions to reduce fragmentation, and to authorize re-opening of auctions, along with the introduction of market standards.HNX is now publishing advance quarterly and annual debt auction schedules on its website and is using indicative prices to build and publish a government bond yield curve. Issuance has benefited from benign market conditions as the Government has continued to auction10 and 15 year government bonds, increasing the average maturity of the debt stock to 3.6 years. The MOF has also issued a revised framework to guide the issuance of municipal bonds and government-guaranteed bonds. Besides, the Government has issued Decree No. 88/2014/ND-CP dated 26 September 2014 regulating credit rating services, forming a legal framework for the development of domestic credit rating agencies, enhancing the value of information and the transparency of capital market.

14. Finally, under Subprogram 2, the government has initiated a number of long needed reforms to embrace international standards and to improve the operations of the financial markets. Foremost among these, the MOF has drafted an amended Law on Accounting to progressively adopt International Financial Reporting Standards including the concept of market or "fair" value.To reduce systemic risk in the securities settlement process, MOF has established a steering committee and working group to develop an action plan to transfer the cash settlement leg of government securities transactions from a commercial bank to SBV and to develop a limited purpose CCP to support the introduction of derivatives trading.. To enhance the confidence of stakeholders, the Ministry of Finance has established a legal framework, governance framework and a complete apparatus as well as allowed the formation of financial resources for the operations of the policy holder protection Fund. Moreover, MOF has published the corporate governance rankings of publically listed companies by group using the ASEAN CG Scorecard and has taken steps to launch an Institute of Directors to advocate and support reforms to corporate governance. The Government has also continued its initiatives to strengthen the capacity of line institutions responsible for financial sector development and supervision, beginning with the SBV.

15. To ensure the momentum for reform is not diminished by these recent achievements, the Government is committed to an ongoing medium-term policy reform program to extend the Government's policy dialogue with ADB beyond FSDP. The Government and ADB will jointly

engage in an ongoing policy dialogue to better refine the reform agenda to ensure the continuing development of the money market, the bond market as well as related financial market infrastructure. The Government also stands committed to take necessary steps during and beyond the program period to support on-going monitoring of progress through a review of the relevant outputs and outcome indicators.

16. To support these reforms, the Government has requested a policy based program loan of $100 million for Subprogram 2. Vietnam's Gross Domestic Product (GDP) growth was 5.2 percent in 2013, 5.9 percent in 2014 and is forecasted to reach 6.2 percent in 2015 if progress is made in reforming the financial sector and the budding recovery in major industrial economies gathers momentum in 2015. The loan amount is based on the financing needs of the government, the strengths of the policy package, and its development impact. Viet Nam's gross financing needs remain high. In 2013, with a budget deficit target of 4.8%, the government will need to borrow VND 162 trillion ($7.8 billion). In 2012, deficit financing was obtained from domestic sources (44%) and external sources (56%), of which some 84% was accounted for by ODA. Assuming a similar distribution for 2013, the government will borrow an estimated $3.7 billion through Official Development Assistance to close the budget gap.

17. In conclusion, the Government of Vietnam acknowledges and appreciates ADB's efforts to support our initiatives to introduce a more modern and market-based financial sector. We further appreciate ADB's commitment to work with the Government over the medium-term in further deepening and reforming the financial sector. We thus request favorable consideration of the proposed $100 million Subprogram 2 of FSDP. We would also like to provide our assurances that the Government will follow up these reforms under the ensuing post program partnership framework.

18. Let me, Mr. President, once again thank you for your support and express the hope that the Financial Sector Deepening Program will be considered favorably by the ADB Board at an early date.

Sincerely yours,

Nguyen Van Binh
Governor of the State Bank of Vietnam

POLICY MATRIX

Policy Actions – VIE Financial Sector Deepening Program (FSDP-SP2)		
	Subprogram 2 Accomplishments (Policy triggers in bold) September 2013 to June 2015 (Policy triggers in bold)	**Post Program Partnership Framework (July 2015 – June 2017)**
	Output 1 - A Well-functioning Money Market.	
1.1 *Development coordination mechanisms strengthened.* ○ ADB TA, Third Financial Sector Program - Subprogram II (TA 7464).	*The government increased inter-ministerial coordination as part of its efforts to improve its macroeconomic framework and further financial sector development. These accomplishments included;* 1. State Bank of Viet Nam (SBV) and the Ministry of Finance (MOF) joined and are participating in a formal Inter-ministerial coordination mechanism which has improved the implementation of the money market development master plan. 2. To improve development of money market, the SBV has restructured the activities and responsibilities of the Money Market Development Working Group (MMD-WG). The Central Banking Department is now the secretariat and membership has been focused on key stakeholders including the Monetary Policy Department, Information Technology Department, the Credit Info Centre, and the Legal Department.	*The government continues to improve the level of inter-ministerial coordination through formal mechanisms.* The government continues and deepens effective coordination under the Inter-ministerial Regulation which supports the development of a more permanent short-term yield curve.

Policy Actions – VIE Financial Sector Deepening Program (FSDP-SP2)		
	Subprogram 2 Accomplishments (Policy triggers in bold) September 2013 to June 2015 (Policy triggers in bold)	**Post Program Partnership Framework (July 2015 – June 2017)**
1.2 *Short-term money market transactions promoted.*	*The government has completed the following key steps under the Money Market Development Master Plan (MMD-MP) which have strengthened the enabling environment, increased transparency and established provisional short-term benchmark interest rates. These accomplishments include;*	*The government continues to implement reforms guided by the MMD-MP.*
○ ADB TA, Third Financial Sector Program - Subprogram II (TA 7484)	3. **SBV is issuing SBV bills with tenors of 28 days, 56 days, 91 days, and 182 days thereby providing provisional short-term benchmark rates at 30, 60, 90 and 180 days which will support the introduction of derivatives such as foreign-exchange (FX) cross-currency swaps.**	SBV and MOF coordinate on the provision of short-term benchmark interest rates.
○ ADB TA, Financial Sector Deepening Program – Subprogram 1 (TA 7895).	4. SBV identified impediments to developing a repo market by completing a legal survey which quantified the risk of recharacterization of repo transactions and identified areas where the legal system should be strengthened.	To support MOF's introduction of "bidding members" and market-making activities, and within the identified impediments, SBV through MMD-WG drafts and adopts the GMRA with Viet Nam Annexes.
	5. The Government authorized the introduction of derivatives based on listed stocks, stock indices, and government bonds.	MOF thru SSC issues a Decree and guiding circular to implement the Decision.

Policy Actions – VIE Financial Sector Deepening Program (FSDP-SP2)		
	Subprogram 2 Accomplishments **(Policy triggers in bold)** **September 2013 to June 2015** **(Policy triggers in bold)**	**Post Program Partnership Framework** **(July 2015 – June 2017)**
1.3 *Operational and regulatory framework enhanced.* ○ CIDA TA, Banking	*The government strengthened the underlying framework to encourage development of a money market by improving information disclosure and transparency, and by requiring more comprehensive and robust liquidity management in the banking sector. These measures include;* 6. To improve the transparency of financial transactions in the money market, SBV is publishing domestic interbank rates and volumes on its website, along with historical data, and has established a working group to launch real time trade monitoring and post-trade reporting for domestic interbank transactions utilizing a Rueters platform. **7. SBV significantly strengthened transparency in the money market by establishing real-time trade monitoring and post-trade electronic reporting for interbank foreign exchange transactions by requiring participants to utilize the standard trading platform for foreign exchange (FX) provided by Thomson Reuters Dealing.** 8. SBV implements required stronger prudential liquidity	*SBV provides complementary granular and real-time reporting of domestic currency inter-bank transactions.* .

Policy Actions – VIE Financial Sector Deepening Program (FSDP-SP2)		
	Subprogram 2 Accomplishments (Policy triggers in bold) September 2013 to June 2015 (Policy triggers in bold)	**Post Program Partnership Framework (July 2015 – June 2017)**
Regulation and Supervision Support Program (BRASS)	management in banks, modeled on Basel III, which includes a dynamic short term cover ratio, a static structural ratio, and requirements for risk management and provides for increased penalties for non-compliance with liquidity requirements.	
Output 2 - A Deeper and More Liquid Capital Market.		
2.1 *Systemic risks addressed and financial stability enhanced.*	*Financial stability, especially with regard to the financial sector and credit risk, is a necessary precondition for capital market development. After completing an FSAP, the Government identified priority recommendations, associated action plans, and named SBV as the overall coordination agency with the objective of addressing NPL's and reducing systemic risk arising from poor credit quality. These measured include;*	*The Government continues to reduce systemic risk arising from poor credit quality and high levels of NPL's.*
○ ADB TA, Enhancing Financial Stability (TA 8538) ○ CIDA TA, Banking Regulation and Supervision Support Program (BRASS)	9. The Government launched specific action plans to; i) establish a framework for financial stability (e.g macro-prudential supervision, systemically important financial institutions and groups, and shadow banking), ii) strengthen supervision and surveillance of the banking sector (e.g. strengthening definitions of "control" and related interests, coordinating off-site and on-site supervision, and anti-money laundering) , and iii)	The Government continues to address priority FSAP recommendations and reduce systemic risk.

Policy Actions – VIE Financial Sector Deepening Program (FSDP-SP2)		
	Subprogram 2 Accomplishments (Policy triggers in bold) September 2013 to June 2015 (Policy triggers in bold)	**Post Program Partnership Framework (July 2015 – June 2017)**
	strengthen the financial infrastructure (e.g. payment system).	
○ JICA TA, Viet Nam Bank Restructuring Support Project (TA)	**10. The SBV increased capitalization and strengthened risk management in the banking sector through the adoption of the standardized approach of Basel II for large domestic banks by end 2015, improved the identification and reporting of NPL's, and implemented an enhanced problem bank resolution regime backed by the revised bankruptcy law.**	The government adopts formal capital adequacy ratio (CAR) in accordance with Basel II; and continues to strengthen the bank resolution framework.
	11. **The Government increased VAMC's capital by a factor of 4 to VND 2,000 billion ($100 million) from VND 500 billion, authorized the entity to issue its own debt to purchase NPL's at market value, sell assets to non-residents, and strengthened its NPL resolution powers to allow asset sales without the owner's consent.**	The government continues to strengthen the bank resolution framework.
2.2 *Framework for bond market development established.* ○ ADB TA, Third Financial Sector	The government provided a basic framework to encourage accelerated development of the bond market by rationalizing and further modernizing the primary and secondary government bond market. Initiatives have been completed with the intent of reducing fragmentation, increasing price transparency, and extending the average maturity structure of the government bond portfolio. These measures include;	*The government continues to accelerate development of the bond market.*

Policy Actions – VIE Financial Sector Deepening Program (FSDP-SP2)		
	Subprogram 2 Accomplishments (Policy triggers in bold) September 2013 to June 2015 (Policy triggers in bold)	**Post Program Partnership Framework (July 2015 – June 2017)**
Program - Subprogram II (TA 7484) ○ ADB TA, Financial Sector Deepening Program – Subprogram 1 (TA 7895)	12. **The government prepared a revised framework to deepen the size and liquidity of the bond market by identifying government bonds to serve as short-term and long-term benchmarks, guiding the issuance of municipal bonds and government-guaranteed bonds, and introducing market standards. Within this framework, the Government continued to issue identified benchmark securities, and extended the average maturity of the government debt portfolio to 3.6 years by continuing issuance of 10 and 15 year tenors.** 13. **The government prepared a complementary framework to introduce a primary dealer system composed of "bidding members", identified their basic rights and obligations, and established an annual review and ranking of the participants.** 14. HNX utilizes indicative prices to build a government bond yield curve and publishes quarterly and annual debt auction schedules on its website as released by Treasury.	MOF continues to implement the bond market development road map and establishes a plan to introduce voluntary pension schemes (ADB support). The government continues to build a reliable yield curve through issuance patterns and by encouraging secondary trading of government debt. The government prepares a framework to introduce SRO's to monitor bond market activity and practices.
2.3 *Supervisory oversight, disclosure and market transparency*	*The government introduced complementary reforms to strengthen supervisory powers, increase transparency, and increase administrative sanctions under recently revised laws and decrees.*	*The government continues to strengthen supervisory powers and increase market transparency.*

Policy Actions – VIE Financial Sector Deepening Program (FSDP-SP2)		
	Subprogram 2 Accomplishments (Policy triggers in bold) September 2013 to June 2015 (Policy triggers in bold)	**Post Program Partnership Framework (July 2015 – June 2017)**
improved.	15. MOF/SSC strengthened reporting and information disclosure by public companies and shortened reporting timelines under Circular 52 by implementing e-reporting through Information Disclosure System (IDS). **16. To enhance and deepen international linkages and cooperation, SSC become a signatory to IOSCO Annex A and strengthened its enforcement capacity under the revised Securities Law, including provisions for sanctions on administrative violations in the securities market and transparency related to firms sanctioned and the amount of fine levied.** 17. MOF adopted a system of penalties and sanctions for violations of the Law on Accounting and the Law on Independent Audit. 18. The government authorized the formation of credit rating agencies, foreign or domestic, and provided implementation guidelines and governance standards.	
Output 3 - Capacity of Public and Private Institutions in the Finance Sector Improved		
3.1 *Structural and operational framework*	*The government has initiated reforms that will introduce international standards and improve the operations of the financial markets, including accounting standards,*	*The government continues to embrace international standards and improve the operations of the financial markets,*

Policy Actions – VIE Financial Sector Deepening Program (FSDP-SP2)		
	Subprogram 2 Accomplishments (Policy triggers in bold) September 2013 to June 2015 (Policy triggers in bold)	**Post Program Partnership Framework (July 2015 – June 2017)**
strengthened	*settlement systems, and governance and investor protection.*	
○ ADB TA, Financial Sector Deepening Program – Subprogram 1 (TA 7895).	**19. To improve investor confidence, MOF under the accounting and auditing strategy and roadmap, has drafted an amended Law on Accounting to progressively base Viet Nam Accounting Standards (VAS) on International International Financial Reporting Standards including the concept of market or "fair" value.**	The government progressively aligns VAS with IAS and IFRS.
○ ADB TA, Promoting an interlinked ASEAN Capital Market (TA7576)	20. To increase trading volumes and efficiencies, SSC completed an action plan for merging HNX and HOSE, and submitted the plan to MOF, and the Prime Minister as mandated in the Securities Market Strategy 2011-2020.	The government merges HNX and HOSE and begins harmonizing operations and systems
○ ADB TA, Third Financial Sector Program - Subprogram II (TA 7484)	21. To reduce systemic risk in the securities settlement process, MOF, through SSC, VSD, and SBV established a Steering Committee & Working Group and developed an action plan to transfer the cash settlement leg of government bond transactions from a commercial bank to SBV and to develop a limited purpose CCP to support the introduction of derivatives trading.	The government completes the transfer of the cash settlement leg of government bond transactions to the SBV

Policy Actions – VIE Financial Sector Deepening Program (FSDP-SP2)		
	Subprogram 2 Accomplishments (Policy triggers in bold) September 2013 to June 2015 (Policy triggers in bold)	**Post Program Partnership Framework (July 2015 – June 2017)**
	22. MOF, through SSC publishes corporate governance rankings of publically listed companies by group using the ASEAN CG Scorecard and completes a draft plan to establish an Institute of Directors to advocate and support reforms to corporate governance. 23. **To increase stakeholder confidence, MOF, through ISA, implemented Circular 101 and established, funded and staffed a policy holder protection fund and instituted a governance framework.**	
3.2 *Institutional capacity strengthened.* ○ World Bank TA, Financial Sector Soundness and Institutional Capacity Building ○ ADB staff resources	*The government strengthened the capacity of line institutions responsible for financial sector development and supervision, beginning with the State Bank of Vietnam.* 24. MOF increased capacity to independently complete debt sustainability assessment DSA's. 25. SBV implements it's the human resource development (training) with a total of 4,789 participants completing a structured regime of soft skills, leadership skills, general professional skills and select advanced technical skills.	*The government continues to strengthen the capacity of line institutions responsible for financial sector development and supervision.*