

Circular 36 from the SBV aims to address a number of matters troubling Vietnam's banking sector.



For safety and growth

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Banks today are facing rapid and irreversible changes in technology, customer behavior and regulation. The combined power of these three drivers of industry change is increasing because they are often closely interwoven. Regulators, however, always play an important role as they are the key determinant of the banking industry's future shape.

After a long time looking into the issues facing Vietnam's banking system, on November 20, 2014, the State Bank of Vietnam (SBV) issued Circular No. 36/2014/TT-NHNN (Circular 36) regulating prudential ratios for the operations of credit institutions and foreign bank branches. Circular 36 will become effective on February 1, 2015 and will replace all relevant applicable regulations.

Circular 36 is seen to meet market expectations in order to strengthen the quality of banking operations through setting and monitoring important prudential ratios. It also helps to direct credit policy in order to ease difficulties in the real estate and securities sectors and stimulate their development. Furthermore, the new regulations on defining related

parties, both for entities and individuals, will also contribute to resolving cross-ownership issues and enhancing transparency in corporate governance as well as other banking services provided by commercial banks.

Circular 36 consists of the following important changes that are considered to have a major influence on banking operations in particular and the market in general.

REAL VALUE OF CHARTER CAPITAL

Charter capital or contributed capital is considered one of the five most important criteria in assessing a bank (the CAMEL model). While legal capital levels applicable to credit institutions and foreign bank branches remain unchanged, Circular 36 provides detailed guidance on the principle, calculation method, periodic reporting and follow-up actions once the real value of charter capital falls below the legal capital requirement. As a result, the circular has ensured consistency in application as well as the requirement for active monitoring and capital management in a safe and effective manner by credit institutions.

MINIMUM CAPITAL ADEQUACY RATIO (CAR)

Under the new circular, credit institutions are required to

ensure compliance with both single and consolidated CAR if they have at least one subsidiary. In addition, the decrease in risk weighting factors applicable to credit facilities granted to the real estate and securities sectors, from 250 per cent to 150 per cent, is seen to have a positive impact on the CAR of credit institutions as well as promoting credit activities in these areas.

CREDIT LIMITS

Apart from prohibited cases as regulated in Article 126 of the Law on Credit Institutions, Circular 36 also states that credit institutions and foreign bank branches are not allowed to provide credit facilities to borrowers who invest in and/or trade unlisted corporate bonds. This will help to enhance credit quality through monitoring the aggregate credit exposure of each borrower and mitigating credit facilities granted in indirect ways to those borrowers who are not qualified for such credit facilities under direct lending.

Circular 36 also limits the aggregate credit exposure to finance shares trading at 5 per cent of each bank's charter capital. It is noted that Circular 36 only sets the limit for credit granting to finance shares trading but not the limit for credit exposure given to trading valuable papers, listed corporate bonds, government

bonds, and stock purchase rights and options.

However, credit institutions are only allowed to grant credit facilities when they meet certain conditions required in Circular 36, especially (i) ensure the limits and other prudential ratios regulated in the circular; and (ii) have a non-performing loan ratio below 3 per cent. Furthermore, commercial banks are not allowed to grant credit facilities to their subsidiaries or associates or to entrust their subsidiaries or associates to (a) invest in and/or trade shares; and (b) lend money to invest in and/or trade shares. They are also not allowed to grant credit facilities to borrowers for investing in shares of themselves except certain special cases stated in the circular. Credit facilities granted by commercial banks and foreign bank branches to borrowers for investing in or trading shares are not allowed to be secured by these acquired shares.

LIMITS ON EQUITY INVESTMENTS

Circular 36 has provided a strong mechanism for monitoring cross-ownership and cross investments. Commercial banks and finance companies are not allowed to invest in their shareholders and related parties of their major shareholders and management. They are also not allowed to invest in their controlling entities or

subsidiaries and associates of their controlling entities. Furthermore, subsidiaries and associates of the same commercial bank or finance company are neither allowed to invest in each other nor to invest in that commercial bank or finance company.

Commercial banks are also only allowed to invest in and hold shares of two other credit institutions at a maximum, except for cases where the other credit institutions are subsidiaries of that commercial bank. The limit for investment in another commercial bank is 5 per cent of the voting rights in that credit institution. Commercial banks are not allowed to participate in the Board of Management of the invested bank, except for in the case where the credit institution is a subsidiary or is directed by the SBV.

LIQUIDITY RATIO, MEDIUM AND LONG-TERM LOANS FINANCED BY SHORT-TERM FUNDING RATIO

Raising the medium and long-term loans financed by short-term funding ratio to 60 per cent will have a positive impact on increasing the proportion of medium and long-term loans by taking advantage of the stability of short-term funding over time. Credit institutions and foreign bank branches are also allowed to invest in government bonds up to a cap of the short-term funding applicable for each type of credit institution. For example, 35 per cent is applied for commercial banks and joint venture banks, and 100 per cent to foreign banks.

LOAN OVER DEPOSIT RATIO (LDR)

Determination of the LDR applicable for each type of commercial bank aims to strengthen the quality of banking operations, as well as to monitor the credit scope of each commercial bank more effectively. For instance, the LDR applicable for joint stock banks, joint venture banks, and 100 per cent foreign banks is 80 per cent. For those credit institutions and foreign bank branches established within the first three years, the SBV Governor will determine the specific level for each type of credit institution and foreign bank branch.

WHAT'S NEXT?

Since the time the new regulation comes into effect is

approaching, commercial banks should have already planned to adopt these changes. It can be foreseen that there will be significant changes in Vietnam's banking system in the next couple of years. The survival of weak banks in the market is particularly in question. The cross-ownership issue will also need great effort to be resolved. Therefore, banks will need to push ahead with adapting to regulatory change and executing compliance, at least at the pace and to the standards expected by their supervisors.

Apart from the regulatory adaption and compliance, with the principle that what doesn't kill you makes you stronger, each bank will have to back its own survival and play to its strengths by building trust, integrity, security and quality of service to the customer by pushing ahead on the following fronts: (i) working through the legacy of underperforming assets and misaligned cost structures, at least at the pace and to the standards expected by their shareholders; (ii) changing the culture and behavior of their organizations by demonstrating security, integrity, dependability and quality in their service offerings to regain trust with all their stakeholders, at least at the pace and to the standards expected by their stakeholders; (iii) investing in customer service and operational innovation, at least at the pace and to the standards set by their competitors.

Managing a transformation program of this scale will be a challenge. However, banks do not need to do all of this in-house, since at least some of the innovation and technology work can be achieved through strategic partnerships or outsourcing to industry-wide utility solutions or professional experts.

In summary, we should be mindful that banking is changing and will continue to change. The issuance of Circular 36 is seen as a positive signal in directing and monitoring the banking system in Vietnam. Along with the comprehensive implementation of other measures by management bodies, we hope for a sustainable banking system in Vietnam that will contribute considerably to the economic development of the country and its international integration. ■

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