Study on competitiveness and impacts of liberalization of financial services: The case of banking services

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CONTENTS

ABBREVIATIONS

ACB	Asian Commercial Bank
AFTA	ASEAN Free Trade Agreement
ANZ	Australia & New Zealand Banking Group
APEC	Asian Pacific Economic Cooperation
ATM	Automatic Teller Machine
BIDV	Vietnam Bank for Investment & Development
BIS	Bank of International Settlement
BTA	Bilateral Trade Agreement
CAMEL	Capital adequacy, Asset quality, Management, Earnings, and Liquidity
CAR	Capital Adequacy Ratio
CCF	Central People's Credit Fund
CEO	Chief Executive Officer
DAF	Development Assistance Fund
EU	European Union
FDI	Foreign Direct Investment
FIEs	Foreign Invested Enterprises
FX	Foreign Exchange
GATS	General Agreement on Trade in Services
GDP	Gross Domestic Production
HRM	Human Resource Management
IAS	International Accounting Standard
ICT	Information, Communications Technology
IMF	International Monetary Fund
JCB	Joint Stock Commercial Bank
M&A	Merger & Acquisition
MFN	Most-Favored Nation
MNC	Multi-national Company
MOF	Ministry of Finance
MOHA	Ministry of Home Affair
MOJ	Ministry of Justice
MPI	Ministry of Planning & Investment
NPL	Non Performing Loan
OECD	Organization for Economic Cooperation & Development
OTC	Over-the-counter market
PBOC	People's Bank of China
PCF	People's Credit Fund

PMU	Project Management Unit
SBV	State Bank of Viet Nam
SMEs	Small & Medium Enterprises
SOCB	State-owned Commercial Bank
SOEs	State-owned Enterprises
SPB	Social Policy Bank
SWOT	Strength-Weakness-Opportunity-Threat
USD	United States Dollar
VAS	Viet Nam Accounting Standard
VBARD	Viet Nam Bank for Agricultural and Rural Development
VBSP	Viet Nam Bank for Social Policies
VND	Viet Nam Dong
VNPT	Viet Nam Post and Telecommunication Corporation
WB	World Bank
WTO	World Trade Organization

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FOREWORD

This is one of a series of studies on *Competitiveness and the Impact of Trade in Services Liberalization in Viet Nam*, conducted in the framework of the project "Capacity Strengthening to Manage and Promote Trade in Services in Viet Nam in the Context of Integration" (or "Trade in Services" Project - VIE/02/009), which is currently being funded by the United Nations Development Programme (UNDP), and implemented by the Department of Trade and Services of the Ministry of Planning and Investment (MPI).

This study presents an overview of the banking sector in Viet Nam, including its reform process since 1990; the legal and policy environment applicable to the sector, and the liberalization commitments undertaken so far by the country. It provides an analysis of the competitiveness of Viet Nam's banking services in the context of recent global sector integration developments; and the possible impact of further liberalization of banking services from two different angles: impact on the sector itself, and on the economy, including social impacts. The report also presents a set of recommendations, including recommendations for improving the legal and policy framework; developing a strategy for the sector; and improving governance and banking operations.

The study was conducted by a team from MCG Management Consulting Ltd. (Viet Nam), composed by Dr. **Le Xuan Nghia** (team leader), Mr. **Vu Quang Thinh**, Mrs. **Dang Nhu Van**, and Mrs. **Pham Ngoc Linh**. During the research, the team received important contributions from Dr. **Nick Freeman** and Dr. **Andreas Hauskretch**. Mr. **Truong Van Doan**, now Vice Minister of MPI, was the National Director of the Project, as well as Dr. **Ho Quang Minh**, now General Director of the MPI Foreign Economic Relations Department; while Mr. **Thai Doan Tuu** and Mr. **Bui Diem** acted as Deputy National Project Director and National Project Manager, respectively. Dr. **María Cristina Hernández**, Senior Technical Advisor to the Project, conceived the study and assisted the team at various stages of the research. Useful comments and inputs came also from Mr. **Thomas Rose**, from the World Bank (Washington).

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1 INTRODUCTION

1.1 Background of the Study

Viet Nam aimed to become a member of the World Trade Organisation (WTO) by the end of 2005. Viet Nam has faced a number of challenges in reaching this goal including inadequacies in its legal framework and procedures in the service sector, including both banking and financial services. One of the Viet Nam's most important tasks is to review its policies governing trade in services in line with WTO requirements, while also implementing other bilateral and multilateral agreements, including ASEAN Free Trade Agreement (AFTA) and Bilateral Trade Agreement (BTA).

Multilateral trade negotiations in business, tourism, telecommunications, transportation, distribution, and finances are expected to be finalized in 2005, or shortly thereafter. Since the Doha Summit in November 2001, Viet Nam has gained ground in trade in services negotiations.

Liberalization of trade in services means that there will be more challenges posed for, and more competition faced by, local service providers in Viet Nam, including domestic banking service suppliers. Increased efficiency in all services sectors will lead to greater FDI inflow, which will in turn stimulate further economic growth and poverty alleviation in Viet Nam.

Given the necessity of issues involved, Viet Nam must strengthen its capacity in trade in services in order to effectively deal with the challenges that lie ahead. The MPI/ UNDP VIE/02/009 project has been designed with the objective of assisting the Government of Viet Nam and Viet Nam to further integrate into the global economy, focusing on trade in services, this includes the strengthening of Viet Nam's capacity to formulate, coordinate and implement policies promoting development of its service sector and to manage and promote trade in services, during increased economic integration.

In order to develop appropriate strategies, Viet Nam must understand the current context of individual economic sectors and their potential for development in the future. The importance of undertaking an impact and competitiveness study should be stressed, in order to properly identify the costs and benefits of service trade liberalization in key sectors. With such an awareness the project and the Ministry of Planning and Investment expects to assist the Government in exploring emerging opportunities, pinpointing potential problem areas and designing coping strategies to minimize any negative impacts, while also formulating appropriate policies to support stakeholders adversely affected by the liberalization process.

Given the essential role of banking services in any modern economy, and through this specific study on competitiveness and the impacts of liberalization of financial services, it is expected that the study serve as the basis for sectoral policy recommendations.

1.2 Objectives & Scope of the Study

The ultimate goal of this study is to firstly, ensure that the liberalization of the banking sector benefits the Vietnamese economy and people, while also reducing any negative impacts arising from liberalization, such as rural/urban disparities and secondly to ensure that such a liberalisation process is consistent with Viet Nam's economic and human development goals.

In order to achieve theses overall goals, a number of objectives have were established:

- Assess the overall competitiveness of Viet Nam's present day banking services. This is not limited to the identification of strengths and weaknesses, but includes determination of obstacles hampering competitiveness in banking services. The benefits and costs of market opening reforms and business liberalization to be stated;

- Assess the impact of Viet Nam's market reforms and trade liberalization commitments in: i) the banking sector itself; ii) on the Vietnamese economy as a whole; and iii) on consumers (both user industries and individuals), with specific attention to poor and disadvantaged groups;

- Understand the readiness of banking services for liberalization, to inform the business community and the general public of the opportunities and challenges arising from liberalization, while also raising awareness of potential negative impacts that such liberalization may have on poor and marginalized people;

- Provide insights into the short and medium term implications of trade related policy on a selection of banking services.

- Assist Vietnamese policy makers and trade negotiators in formulating appropriate domestic policies and coherent negotiating positions in this sector, in accordance with the country's socio-economic development goals, while supporting WTO accession negotiations and adhering to other regional and bilateral negotiations.

The study has reviewed documents on Viet Nam's banking sector, the country's WTO accession bid and economic policies and regulations imposed on the banking sector and information obtained from this review has served as the foundation for further fieldwork in this assignment.

The field study, which was divided into two phases, was intensively implemented over a two-month period. The first phase consisted of in-depth interviews, consulting a total of 18 regulators and credit institutions, and five corporate bank users throughout the country. The second phase, which focused on the collection of quantitative data, started upon the completion of the first phase. More than 200 corporate users and 300 individual users were invited to take part in the survey. nformation from both desk research and field study was analyzed to develop the reports findings and recommendations.

1.3 Limitation of the Study

At the time of writing this report Vietnamese negotiating teams were continuing to work on the finalisation a number of as yet uncompleted bilateral negotiations with these negotiations expected to progress and be completed over the next few months. The findings of this study are to the end of 2005. However, in order to present an overall view of the current situation the study does include the Hong Kong WTO meeting in December 2005.

The study also obtained the views from sector regulators and providers and also users of the banking sector. Had resources and time permitted we would have wished to have conducted a larger and more comprehensive survey. As such, the conclusions and data gathered from the survey were handled and analyzed with this limitation in mind.

2 International Context

Under bilateral trade agreements, developing countries such as Viet Nam are obliged to lift restrictions on both the entry and business activities of foreign companies in the local market. Consequently, Vietnamese enterprises (including banks) will be faced with difficulties arising from increased competition. A review of determinants and trends driving developments in the global banking sector will help identify crucial factors that determine the trends and future success of the local banking sector.

A predominant international trend is consolidation, internationalization and conglomeration of the banks of developing and developed countries. A 2003 IMF report[1] stated that while consolidation trends are increasing around the globe, internationalization and mergers are not keeping the same pace across different regions. Another emerging trend sees banks providing a wider variety of financial products in order to take full advantage of their resources. One lesson Viet Nam must learn quickly is that as a WTO member the banking sector, which is undoubtedly subject to liberalization, will be influenced by the trends and challenges of the global banking market.

2.1 The Nature of International Integration in Financial Services

The financial sector must be liberalized in order to integrate into the international financial market. Financial liberalization specifically means removal of constraints and limitations in credit allocation. The management of this allocation should be derived from a pricing mechanism, under which financial institutions are allowed to determine their deposit and loan rates. Liberalization will also lead to the elimination of interest ceiling rates and other constraints on the use of capital. Financial liberalization will promote greater growth in competition amongst financial institutions, marked by an end to the current legal discrimination between different types of institutions. Liberalization will also minimize State interventions in financial relationships and transactions allowing the operation of a market mechanism.

Financial liberalization often includes removal of control over interest rates and financial activities, reduction of required reserve ratios, diminishing capital subsidies through credit direction, liberalizing foreign currency exchange, and loosening controls over the activities of financial organizations.

As there is no uniform approach to financial liberalization, each country must identify liberalization procedures for its domestic financial sector according to its own social and political landscape. Viet Nam is gradually implementing its own approach to financial liberalization and the major policies spearheading this approach are described in the following table:

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[1] IMF working paper WP/03/158: Bank consolidation, internationalisation, and Conglomeration: Trends and Implications for Financial Risks

Table 1: Policy roadmap

Year	Policy Roadmap
1991	Reduce state budget deficit to less than 5%, required reserves to less than 10%
1997	Apply a flexible exchange rate mechanism
2002	Establish Social and Policy Bank
2002	Apply a negotiable interest rate mechanism
2004	Allow the establishment of 100% foreign-owned financial companies
2007	Remove limitations on 100% foreign-owned insurance companies
2011	Remove limitations on 100% foreign-owned banks

Source: State Bank of Viet Nam, 2005

The nature of international integration in financial services can be observed in different ways. It is a process by which countries and regions become open to the involvement of external elements in financial areas, including capital (direct and indirect investment), technology, credit, and highly skilled labor. International financial integration is also a process by which domestic factors enter other countries[2].

International financial integration may be pursued by nations in response to external factors. International economic organizations or alliances (such as APEC, WTO, or ASEAN) can put pressure on their member countries, or members may be obliged to follow organizational decisions governing the opening of markets. As international financial integration is a process of adjusting business operations, laws, financial policies, and regulations, processes must aim to harmonize and unify both external and internal elements.

International integration of financial services is also a process of alignment of institutions, regulations, policies, standards, principles, and laws that govern finance. The essence of the alignment process lies with different countries commonly agreeing on financial treatments (tax, insurance and banking) for the benefit of each other's economic activities. The process is also the result of adjustments made by the nation and its enterprises. The greater integration is the more practices and common regulations aimed at uniformity and harmonization of financial policies are required.

International integration of finance is a continuous process, as the driving force behind it is the development of the scientific, technological and economic powers of a given nation. As these factors grow, financial integration is sooner realized and reflected in a wider range of aspects, such as the extent of capital and labor exchanged. International practices increase and develop between the financial relationships of organizations and institutions.

Finally, international financial integration is a cooperative process. Cooperation between nations develops in accordance with the need to rely upon one another. However, some uncertainty remains

[2] According to GATS, the corresponding "mode of supply" in which services are delivered: i) Mode 1 – "Cross Border" supply occurs when a service supplier located in one country provide services to a customer in another country; ii) Mode 2 – "Consumption abroad" occurs when a national of one country travels to another country, where it is then supplied with the service; iii) Mode 3 – A service supplier is said to have a "Commercial Presence" when it sets up a branch or subsidiary in another country in order to provide a service there; and iv) Mode 4 – "Presence of a natural person" refers to situations in which a person travels from one country to another and there provides a service to a customer.

as to how a country should coordinate with others; an issue that economic organizations and international institutions must deal with, rather than expecting individual nations to manage on their own.

The international integration of financial and monetary operations is gradually seeing harmonization between domestic (Viet Nam) and international financial sectors. This process is supported by increasing international cooperation and market openness; as well as by the implementation and adjustment of institutional and international standards of individual nations.

2.2 Recent Trends in Internationalization of Financial Services

2.2.1 Internationalization trends in banking services worldwide

The last two decades show a shift from international banking into globalized banking. International banking has traditionally been cross-border banking with funds attracted domestically being lent abroad. Today, global banks enter foreign markets by opening branches and subsidiaries and attract funds and lend them to locally-based clients (Mode 3). They engage in such services as consumer lending, mortgages, corporate loans, asset management, and capital market strategies.

The significant growth of commercial banks and automated processes within the context of increased competition has encouraged banks to expand their operations to take advantage of economies of scale. Network expansion may include the establishment of new branches, trade centers and points of sale. Larger banks are increasingly looking to acquire shares in banks with smaller operations as a means of integrating the smaller operators into their networks. Mega consolidations have arisen from such practices, including Chemical Bank, Chase Manhattan, the Bank of America, National Bank, and most recently Tokyo Bank and Mitsubishi Bank. Increasingly operational expansion, in terms of geography, consolidation and the mergers of banks, reaches beyond borders. Large banking conglomerates include Japanese, American, French, German and British banks, have appeared on every continent, and compete with each other globally.

Bank development is the driving force of the world economy. Of the 500 largest financial groups in the world at the end of the year 2000, 362 were owned and managed by banks, accounting for 74% of total asset of the 500 financial groups. Internationalization in banking services encourages further consolidation, internationalization and mergers amongst banks[3]. These trends are discussed at length in the following section.

Consolidation

De Nicolo (2003) summarized that in the 1990s there were a large number of mergers & acquisition (M&A) among financial groups, with considerable activity between 1997 and 1999. In America, M&A deals in the banking sector were at an all time high between 1998 and 2000. Many of these consolidations were between effective branches of different banks in order to increase the fiscal capability of the new bank.

A study of G10 banking sectors identified a decrease in the number of banks that coincided with an increase in industry concentration, as measured by the percentage of a country's deposits controlled by its largest banks. This study also concluded that the driving forces that encourage consolidation are improvements in information technology, financial deregulation, globalization (of both financial and real sectors), and increased shareholder pressure for financial performance. In another study by BIS (2001) and IMF (2001), two other factors were identified as contributing to consolidation: banking crises and the privatization of state-owned banks. Lindgren et al (1999) showed that in some

[3] IMF working paper WP/03/158: Bank consolidation, internationalisation, and Conglomeration: Trends and Implications for Financial Risks

countries banks fell into financial trouble with some becoming bankrupt. Governments often subsidized these banks and arranged consolidation of these troubled institutions into other organizations.

A standard measure of consolidation is concentration. The assets and deposits of large credit institutions are employed to create a ratio. Any increase in a concentration ratio is the indication of an increase of consolidation and vice versa; a decreasing ratio of capital concentration could be the result of either the entry of new banks or concentration among smaller firms, or both.

De Nicolo (2003) used data from IFS, OECD & FITCH – IBCA to calculate the capital concentration ratio of the three largest banks in 115 countries, and for the five biggest banks in 95 countries. Data analysis demonstrated a growing portion of market share in banking for the America, Western Europe, some Eastern European and Latin American banks. However, the ratio declined in Africa, Middle Asia and a few other individual nations. The unequal increase could be blamed on differences in the development of countries, but it did show that consolidation was only occurring in certain regions and countries, rather than on a global scale.

Internationalization

Bank consolidation took place not only within countries but also across borders. Smith & Water (1998) recorded a growth in transactions among countries between 1985 and 1995. Of these, 15% were deals under which banks in developed countries bought out financial institutions in emerging countries. BIS (2001) also revealed that internationalization in emerging countries was reflected in the increased number of foreign banks in developing countries. Expansion around the globe relied on income probability, weighed against the legal environment in the recipient country. Large banks with high profitability and based in developed countries were seen to buy stakes in promising banks in countries that showed potential, even if the capital concentration ratio of the banking sector in these countries was low and local legal frameworks incomprehensive.

De Nicolo (2003) estimated internationalization by analyzing data collected on foreign-owned banks in 105 countries. Internationalization grew significantly in wealthy nations from 15%-20% until the 2000. As with consolidation, the regional distribution of internationalization was unequal. Western Europe recorded the highest growth rate, 67% of total assets held by globally owned banks, followed by the United States of America at 22%, with US increases mostly attributed to international expansion by European banks. The study also recognized that internationalization occurring in low and medium income countries was determined by the appearance of attractive investment opportunities. Internationalization is on the rise in wealthy countries, and on the decline in poorer nations. The data also indicates internationalization is mainly region-oriented, rather than global.

Consortium

Information technology and deregulation have pushed the development of consortiums in industrialized nations. While such factors are emerging in developing countries, they have not yet reached a level to drive the formation of consortiums.

De Nicolo (2003) used financial data from the worlds' 500 largest financial groups, decided by asset holdings between 1995 and 2000, to assess consortium trends around the globe, including those in emergent economies. Estimates peg the concentration ratio of financial groups at an increase (total asset). In 2000, of the 50 biggest firms 92% were consortiums (holding up to 94% of the total assets of those studied). Of the 500 biggest financial organizations, only 60% were consortiums; the same rate was also found in the largest 100 and 250 financial organizations.

The government trend to deregulate multi-national banking activities has also encouraged banks to introduce more comprehensive services. Global banking services require international operations, such as e-banking and Internet banking. Trade liberalization invites strong international capital flows. Liberalization in financial services is unavoidable when a country has chosen the path of open trade markets. Liberalization in the financial and banking sectors significantly impacts income, growth, quality and effectiveness of investment, as well as the prudent allocation of resources.

Levine (1996 and 1997) and King and Levine (1993) stated that developing and developed countries who open their banking and financial sectors are more likely to grow more quickly than those that do not. Jayaratne and Stranhan (1996) found that the deregulation of state branches in the United States stimulated GDP growth of 0.3 - 0.9% in the 10 years after the decision was made and from 0.2 - 0.3% thereafter[4].

In addition to the formation of mixed ownership banks (both multi-national and trans-national) and a diminishing role of the State in bank operations, significant accumulation and concentration were recorded in the banking sector. Consolidation, mergers and acquisitions to form large banks, consortiums and trans-national or multinationals have proven effective for banks worldwide with powerful banks now having an influence over foreign economies as well as the economy of their home country

Internationalization in banking services result in:

- Changes in competition and legal environments add new features to financial environments, directly impacting on financial institutions and often requiring them to be restructured;

- Banks cope with enormous competition from local and international markets, particularly when modern banking technology is applied widely; and

- The existence of too many banks in one single country (as in the United States, where there are around 6,000 banks operating tens of thousands of branches nationwide, while Germany has 3,500 banks with 6,500 branches) leads to an imbalance between supply and demand. Banks face the threat of deficiency in profits domestically and have to expand their coverage.

In such a competitive environment and international scenario banks must work hard to gain top bank rating positions. These ratings demonstrate the competitive capability of each bank and also of the banking system in each country. The following internationally applied indicators have been used to establish ratings:

- Indicators reflect the competitive capacity of credit institutions and include for quality and capacity of human resources, banking technology, financial capacity, management, reputation and brand value;

- Indicators reflect policies to formulate, develop and use competitive advantage including indicators on the efficiency of development policy and rational usage of human resources, of banking technology, of financial capacity, of organization, and of brand value; and

- Indicators on the results of the implementation of strategies and competition strategies measuing changes in market share, or the growth rate of market share in major markets, increasing portion of revenue from services using high-technology, or new products introduced in new markets and additional revenue from competition supporting solutions.

Today, several indicator systems are applied to rate credit institutions. The most commonly applied of these is the Capital adequacy, Asset quality, management, Earnings and Liquidity (CAMELS) system.

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[4] Riegel-Neal Interstate Banking and Branching Efficiency Act in 1994 which lifted restrictions on interstate branching

Under this system, credit institutions are rated in terms of capital, total asset, management, profitability, liquidity, and market response. Credit institutions are then rated from "AAA" to "CCC", by order, or by criterion, by international rating agencies such as Moody's and Standards & Poor[5].

Globalization of banking services continues to develop rapidly and is a real threat to the market shares of Vietnamese banks. Vietnamese banks have acknowledged the importance of internationalization of the banking sector and realize that they need to be strong and competitive enough to withstand integration. This will assist them in strengthening their ratings position against regional and international banks, in terms of capital, total assets, management, profitability, liquidation, and market response.

2.2.2 Internationalization trends in banking services in Viet Nam

The banking sector has undertaken active transformation under Vietnam's continued policy of economic reform and integration. A monopolistic banking system has been replaced by a two-tier system, under which a variety of credit institutions can operate. Changes in national monetary policies (both in tools and mechanism) have paved the way for local banks to follow internationalization trends. Branches of foreign banks have acknowledged the transformation within the sector and are following suit. Two foreign bank purchases of stakes in two major local commercial joint stock banks in early 2005 (ANZ bought shares of Sacombank and Standard Chartered Bank acquired shares of ACB), is heralded as a confirmation of the development trend among foreign banks in Viet Nam.

The issue of the autonomy of credit institutions has been resolved and they are now able to make independent decisions concerning loans, mortgage requirements, and interest rates for both deposits and loans. Discrimination between state-owned and private companies in financial operation has been minimized and different credit institutions are ostensibly treated equally when doing business, pursuant to applicable laws, particularly the Law on Credit Institutions. Commercial business and social-policy functions are being separated into state-owned commercial banks. A Social Policy Bank has been established with its functions tied to social policy.

The State's role in finance, including its stake in state-owned banks has also changed. SOCBs are to implement equitization plans following market principles. The position of State Bank has been improved[6] with the State Bank minimizing administrative intervention in the operations of credit institutions. The State Bank is also eliminating "sub-business licenses" and is improving its internal administrative procedures in accordance with nation-wide administrative reforms.

The convertibility of the current account has also been improved, with the Vietnamese dong showing consistent stability and emerging as a transferable currency. Policies and regulations ensuring the operational safety of credit institutions are built upon on and adhere to international standards. Direct tools used to manage monetary policy were replaced with indirect tools that match market principles.

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5 Ensured protection of public interests and economic stability in each country, region and around the globe requires the rating of credit institutions. The ratings also protect the global economy from sudden changes in big banks or banking groups which are likely to cause economic shockwaves. The collapse of a bank can cause an economic crisis, and further collapse of financial systems around the world. In addition to these protective features, each bank's worth and stock are reflected in the ratings.

6 Primarily the State Bank has demonstrated independence in formulating, implementing and managing national monetary policy. The State Bank manages debts and payments from foreign organisations, currency exchange deals, currency reserves, ensures the stability of the local currency, and mints legal tender.

Banks and credit institutions have been modernized by harnessing new technologies and updating services and products, linking their networks in an effort to increase ‘one-door’ transactions. Services offered by Vietnamese banks have become more diverse, meeting commitment challenges set out in bilateral agreements, such as the Viet Nam US BTA, the Viet Nam – Japan agreement on trade liberalization, promotion and protection of investment; and other commitments signed within organizations such as ASEAN, ASEAN +3, APEC and the soon WTO.

3 Banking Sector in Viet Nam

This section provides an overview of the current status of the banking sector with a focus on different banking groups, Vietnamese banks and foreign banks. A more detailed overview of the banking sector in Viet Nam (including the development and major reform of the banking industry and the state-owned enterprises) is presented in Appendix 1.

The banking sector in Viet Nam has undergone dramatic restructuring and reform. While important progress and changes have been made a number of hindrances still remain. It can be argued that only 'modest' success and restructuring has been achieved due to the States decision to retain complete ownership and governance of banks. While banks have seen the modernization of their institutional structures, increased supervision and regulation has also been employed with the supervisory functions of the State Bank being hampered by its representative role of State ownership in SOCBs.

In the early 1990s, Viet Nam's banking sector moved from a monopolistic structure to a two-tier system, with the separation of state-owned commercial banks from the State Bank of Viet Nam. A large number of joint stock banks have been established and the presence of foreign bank branches and joint ventures has also increased over the last decade. The presence of credit cooperatives/credit funds, micro finance institutions (MFIs), and financing and leasing companies in the domestic market has also made the local banking market increasingly diverse (see Table 2). The sector is clearly moving towards a system broadly similar to that in other emerging markets and newly developed economies.

Table 2: Banks and non-banking credit institutions in Viet Nam

#	Type of credit institution in Viet Nam	Number
1	State Owned Commercial Bank	5
2	Viet Nam Bank for Social Policies (VBSP)	1
3	Joint Stock Commercial Bank	34
4	Joint Venture Bank	4
5	Branch of Foreign Bank	28
6	Financial Company	5
7	Finance Leasing Company	8
8	People's Credit Fund (PCF)	901

Source: State Bank of Viet Nam, April 2005

The following section compares Vietnamese credit institutions and their foreign counterparts, comparing market share, financial strength, technological levels, and corporate governance.

3.1 Vietnamese banks

The domestic Vietnamese banking group includes 5 State owned commercial banks, 1 policy bank and 34 joint stock commercial banks. This group dominates the deposit and lending market, with a consistently high share (see Table 3). This dominance is due to several advantages available as local operators, including few restrictions on area coverage or limitations on the number of branches in any given locality. Their foreign competitors, on the other hand, experience several restrictions on deposit taking in the local market. The long established client base of local SOCBs, mainly state-owned institutions, has further strengthened the Vietnamese banking sector.

Table 3: Market share of Vietnamese commercial banks Unit: %

	2000	2001	2002	2003	2004
Market share of Vietnamese commercial banks in deposit					
State owned commercial banks	77	80.1	79.3	78.1	75.2
Joint stock banks	11.3	9.2	10.1	11.2	13.2
Total	**88.3**	**89.3**	**89.4**	**89.3**	**88.4**
Market share of Vietnamese commercial banks in lending					
State owned commercial banks	76.7	79	79.9	78.6	76.9
Joint stock banks	9.2	9.3	9.5	10.8	11.6
Total	**85.9**	**88.3**	**88.4**	**89.**	**88.5**

Source: State Bank of Viet Nam, May 2005

While SOCBs continue to focus on serving large SOEs, JSBs have found a lucrative niche in serving emerging SMEs and individuals. Non-banking credit institutions and the Social Policy bank play an essential role in providing funds to rural areas and underprivileged people. It is widely believed that the total market share of Vietnamese credit institutions in credit and lending operations will not change dramatically in the near future. However, there may be some changes within this structure with a possible swing in market share towards JSBs.

In terms of financial strength, though there has been a remarkable improvement in the capital base of Vietnamese credit institutions, their financial capacity is still considered weak. In the last four years, their total chartered capital has increased by a factor of 3.5 times, from VND 6,000 billion in 2001, to VND 21,000 billion in 2004. However, the average chartered capital of both JCBs and SOCBs remains low, ranging from 20 to several hundred million US$ respectively. These figures are not only modest in comparison with foreign banks, but also limit their lending capacity due to the mandatory 15% ceiling set by the Law on Credit Institutions, meaning that they are unable to lend more than 15% of their chartered capital to one single borrower. The capital adequacy ratios (CAR) of commercial banks remains lower than the international standard of 8%, which restrains banks from technological upgrades and introduction of new services, such as e-banking and ATMs, due to the need for substantial investment.

In terms of technology and IT application, SOCBs and JSB have shown considerably adoption of IT and technology, with JSBs investing heavily in technology and SOCBs implementing a "Modernization of banking and payment system" project. Advanced banking services such as Internet and phone banking have been introduced by a handful of commercial banks. The market is in the throes of "ATM competition", in which three banks have issued international debit/credit cards and 15 banks have issued domestic debit cards. At least 700 ATMs have been installed countrywide, with almost one in every major urban centre. However, ATMs are linked to individual banks rather than being linked to a single system, reducing convenience for bank clients as well as cost effectiveness for banks.

Corporate governance covers a wide range of aspects, such as human resource management, credit-debit management, risk management, internal control, internal audits, and network management. This issue is considered critical for Vietnamese commercial banks since many of their corporate leaders have not been trained in bank management. Although bank specialists and professionals are found in middle management positions, it is commonly felt that the managerial teams of local banks need greater experience and skills in bank management, analysis and risk management. This, together with constraints in human resource management, particularly in the SOCBs, has hindered bankers from active participation and accountability in their management.

Viet Nam Bank for Social Policy, People's Credit Funds and Postal Savings

The Viet Nam Bank for Social Policies (VBSP) was established to take over small-scale policy and directed lending programmes previously administered by SOCBs and other government entities, including the Viet Nam Bank for the Poor (VBP). This was carried out in recognition of the need to seperate policy lending programs from the State Owned Commercial Banks (SOCBs) and to consolidate numerous policy lending programs into one institution. The bank became operational on March 11, 2003, and its institutional arrangement envisions a non-profit bank that offers a full range of financial products and services at subsidized rates. The bank is exempt from many of the regulatory provisions that govern the operation of SOCBs and will not be covered by the proposed regulatory framework for microfinance institutions (MFIs)[7].

The People's Credit Fund (PCF)[8] is a form of co-operative credit organization operating according to the principle of voluntary membership, autonomy and self responsibility for its operating results. Established in 1993, the PCF network consists of 905 grassroots PCFs and a Central People's Credit Fund (CCF) with 24 branches and operates in 53 of Viet Nam's 64 provinces and cities. Approximately 4.8 million individuals are reached by the PCF network. 84% of PCFs' assets are funded internally, through savings and capital, contributing to their autonomy. PCFs have limited coverage in Viet Nam's poor regions, such as the northern mountainous areas. As of November 2004, PCF had assisted 955,657 households, mainly farmers and small entrepreneurial households.

Viet Nam Postal Savings Company (VPSC) was established in 1999 as the financial arm of the Viet Nam Post and Telecommunication Corporation (VNPT). It provides funds for the Development Assistance Fund and also invests in VNPTs telecommunication projects. VPSC targets clients from all of Viet Nam's population and aims to attract their small amounts of idle money through its existing post office network. In its early stages the facility offered two basic deposit services, term deposits and accumulative deposits, through 39 post offices within its extensive network. After this pilot period, VPSC quickly extended these two services to a wider network of 4,800 post offices nationwide and expanded its range of services to include telegraphic transfers, individual savings accounts, domestic and international remittances.

The VBSP and PCF, along with other government programs, have reached only a subset of Viet Nam's poor population. SOCBs and government programs appear to reach only the upper quintiles of poor households. VBARD serves households with an average annual income of VND 1.8 million, VBP serves those with an average income of VND 1.3 million while the People's Credit Funds serve those with an average annual income of VND 300,000. VBSP operations are entirely dependent on government funds, guarantees and interest rate subsidies. The bank lends to clients at below market rates and pays no interest for a large part of its funds, while also receiving an explicit government guarantee and interest rate subsidy for the bulk of its funding. While VBSP built impressive structures and processes, its operations were not financially or institutionally sustainable without these support mechanisms. On the other hand, PCFs are shareholding banks and do not target the poor directly. They are providing a viable rural finance system to farmers and small entrepreneurial households stimulating economic development, which indirectly contributing to poverty eradication.

With an extensive network of post office nationwide and having a wide range of products on offer, VPSC has gradually captured a substantial share of the local financial market. Since its establishment, VPSC has provided DAF with VND 8,500 billion accounting for 14.6% of DAF's

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7 World Bank (2004), Financial Sector Policy Issues Note: Viet Nam Bank for Social Policies.
8 The People's Credit Fund (PCF) is modeled on the Caisses Populaires credit union system, established a century ago in Quebec, Canada

domestically mobilized funds. Once an adequate legal framework for the operation of postal savings service is established, VPSC plans expand its product base to include a range of products similar to those on offer by offer by commercial banks. When VPSC establishes these new services it will become one of the largest financial sector players in Vietnam.

3.2 Foreign banks

According to the Law on Credit Institutions, 100% foreign owned banks are allowed to establish in Viet Nam, though none have been established yet. There are currently three types of foreign credit institutions operating in Viet Nam's market, branches of foreign banks, joint-venture banks, and 100% foreign owned credit institutions (including joint-venture financial companies, 100% foreign owned financial companies, joint-venture financial leasing companies, and 100% foreign owned financial leasing companies). It is argued that foreign banks prefer to operate in Viet Nam without having a Vietnamese legal entity status. With foreign status (i.e. representative office or branch), operations are not fully governed by local laws and legislation. When first starting operations it is important for foreign banks to explore the local market and determine their potential client base, leading banks to start small while they gradually get to know the market.

The foreign banks account for just 10% of market share in both credit and lending activities. (see Table 3). Foreign banks face restrictions in the type of clientele they serve as well as the amount and type of currencies they can hold and trade. The extent of these restrictions varies between foreign banks (US and European banks face less restrictions), joint-venture banks and financial (leasing) companies. Nevertheless, foreign credit institutions have a number of advantages that could potentially overcome this low market share. Foreign banks are not constrained by the 15% ceiling of chartered capital for one single loan as the rate is calculated on the basis of the entire overseas group. Foreign banks are able to rely on the large capital base of their parent banks. Foreign banks also have extensive experience in project appraisal, risk rating and debt management resulting in low NPL rates. Foreign banks, unlike Vietnamese banks, do not do not have to adhere to the stringent lending policies stipulated by the Vietnamese government.

Table 4: Market share of foreign banks

Unit: %

	2000	**2001**	**2002**	**2003**	**2004**
Market share of foreign banks in credit					
Branch of foreign banks	9.2	8.8	8.1	7.8	8.2
Joint venture banks	1.1	1.2	1.3	1.5	1.5
Total	**10.3**	**10**	**9.4**	**9.3**	**9.7**
Market share of foreign banks in lending					
Branch of foreign banks	11.3	9.5	7.7	7.7	8.3
Joint venture banks	1	1	1.1	1.2	1.2
Total	**12.3**	**10.5**	**8.8**	**8.9**	**9.5**

Source: State Bank of Viet Nam, May 2005

During our discussions with foreign banks operating in Viet Nam, they have expressed the view that the market share figures may only reflect the total lending market size. If preferential loans from SOCBs to Government projects were excluded, foreign banks share of the market (under fair competitive practices) would be higher, perhaps as much as 15-17%. It is also commonly found that a foreign bank is the preferential agent for foreign-invested companies. The strict application of international standards in financial management such as CAMEL(S) helps to ensure accountability and soundness in the financial operation of these banks.

Foreign credit institutions are extremely strong in technology and corporate governance and are often ahead of Vietnamese banks in the introduction of modern banking services, such as e-banking and derivatives. Although the current market demand for these services is low, a gradual increase is expected and will definitely account for a significant part of bank revenues in the future.

4 Review of the Legal and Policy Environment for Banking Services

This section will review and compare current banking regulations and the commitments that Viet Nam has made (and will undertake) in banking liberalization. The review is making the assumption that having become a WTO member, Viet Nam would be required to perform its initial commitments on liberalization scheduled in its service offers, or to perform more than those commitments, depending on the outcomes of its on-going negotiations.

This comparison will reveal the changes in the legal environment, and impacts on the banking sector and domestic banks. The US-Viet Nam Bilateral Trade Agreement (BTA) which was constructed on the basis of WTO principles and came into effect in 2001 has already had an impact on local banks. The inclusion of Viet Nam's commitments under the BTA will assist us to project the impact of future commitments under WTO. Other WTO members have requested Viet Nam to offer similar commitments, effectively creating a multi-lateralization of the BTA, which will see future WTO obligations similar to those under BTA, or greater.

This section makes reference to commitments made by China and Cambodia in trade liberalization and the impacts in their post-WTO accession period. These findings provide useful lessons for Viet Nam in analyzing the competitiveness and weakness of domestic banks, and in implementing WTO commitments in the future.

4.1 Domestic Legal Framework

The legal framework governing the banking sector has seen ongoing improvement effort. In 1990, two banking ordinances were issued setting the legal foundations for the transformation to a two-tier banking system. The two ordinances were redrafted in 1997 into the Law on the State Bank and the Law on Credit Institutions coming into effect from October, 1998. These laws have paved the way for a more level playing field for credit institutions, contributing to the stabilization and development of the country's economy and were again revised and amended in 2003 and 2004, to reflect current and future economic development needs and deficiencies in banking services, raising operational quality, management capacity, while encouraging the autonomy of credit institutions.

The amendments specifically aimed at building a modern banking system that would follow international best practices, eliminating administrative burdens, minimizing unnecessary interventions by the state authority over credit institutions, expanding and redefining forms of credit institutions, consolidating the legal system, meeting requirements of regional and international integration, and preparing for the future WTO accession of Viet Nam[9]. In the Law on State Bank of Viet Nam, four articles were amended changing monetary management policy, such as clarification of banking operations and regulations on open market operation. The Law on Credit Institutions saw 20 articles amended, including clarification of the differences between preferred credits, commercial credits, arrangement and activities of credit institutions. The revised law clarifies the definition of banking terms, the establishment of subsidiaries, board of directors, general directors, and internal supervision[10].

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[9] For example, Decision 42-2003-QD-NHNN of the State Bank of Viet Nam dated 13 January 2003 outlines plans for reform in Viet Nam's banking sector. Decision 109-QD-NHNN of the State Bank of Viet Nam dated 30 January 2004 lists legislation for issuance by the State Bank in 2004.

[10] The Project VIE/02/009 paper "Strategy for the development of banking services in Viet Nam in the context of international economic integration" provided detailed comparison of the revised laws with the former ones. Full legal updates on recent legal banking reforms prepared by Phillip Fox can be found at http://www.usvtc.org/updates/legal/PhillipsFox/RecentBankingReforms.pdf

4.1.1 Monetary policy management

Since the 1990s, the State Bank has succeeded in managing monetary policies, stabilizing currency value, controlling inflation, promoting economic growth, and ensuring the sustainability of credit institutions. The State Bank has put a great deal of effort into formulating and improving monetary policy tools in line with international standards. Initially, as the money market was still underdeveloped, the Bank utilized more direct tools, such as credit thresholds, to manage its monetary policy, but switched to more indirect monetary tools from 1998, including:

Open market operation: this technique has been employed since 2000, and is still commonly used by the State Bank.

Recapitalization: re-capitalizing from the State Bank of Vietnam to commercial banks is mainly in the form of discounting, re-discounting, and guaranteed loans by valuable notes (lending on assurance of valuable documents). Government directed loans, which account for a large proportion in recapitalization, have gradually reduced. Procedures for recapitalization have been simplified and are applied (relatively) equally to all banks, regardless of the type of ownership.

Compulsory reserves: SBV has gradually reformed and improved regulatory capabilities in required reserves in compliance with international practices, which have facilitated credit institutions in flexible capital use. SBV has issued required reserve regulations for term deposits since 1995, which applied to both term and non-term deposits and which has expanding from less than 12 months to less than 24 months. Since August 2003, credit institutions have been permitted to include their deposits in SBV branches as required reserves. SBV also applies different reserve requirements for USD and VND.

Since July 2001, SBV has also undertaken foreign currency swaps as one of its monetary policy tools. This has injected more Vietnamese currency into local credit institutions, particularly those that had previously encountered Vietnamese dong working capital difficulties.

Interest rate management mechanism: Since 2002, SBV has used negotiable interest rates, applied to VND loans from credit institutions. These interest rates are based on basic rates which are determined and published by SBV. This is a breakthrough in SBV's monetary management policy. Credit institutions are encouraged to expand their networks to further source capital and provide loans at market interest rates. This has in turn allowed banks to have more autonomy, and consequently increase their competitiveness in the market.

Exchange rate management: Since 1999, SBV has made a number of fundamental changes to its exchange rate management, shifting from an administrative approach to a market principle approach managed by the State. Accordingly, instead of announcing a formal exchange rate, the State Bank publishes the average exchange rate in the inter-bank market at the nearest working day, commercial banks are then allowed to adjust exchange rates within a margin of +/-0.25%[11].

Foreign currency management: SBV has increasingly liberalized its foreign currency management mechanism in order to attract more foreign investment, including reducing its remittance rate from 80-100% in 1998 to 0% in 2003. Regulations concerning the opening of accounts in foreign currencies and carrying foreign currency cross-border have gradually been loosened. Regulations on the management of overseas borrowings by enterprises and other related policies have become more flexible, improving the autonomy and accountability of Vietnamese institutions.

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[11] The margin rose from +/-0.1% in July 2002.

Credit mechanism: The revised credit mechanisms permit credit institutions to have a certain level of autonomy and accountability in their lending decisions (borrowing conditions, loan requirements, interest rates, loan amounts, terms, and loan method), in choosing customers and credit guarantee measures based on commercial principles and have helped credit institutions to expand their credit activities.

Payment operation policy: In recent years, the government and the State Bank have improved the legal framework concerning banks and non-cash payments. A number of legal documents on payments have been issued, including a decree on payment through credit institutions providing payment services, a decree on issuing and using cheques, regulations on payments through service suppliers and regulations on electronic and inter-bank payments. The move encourages both banks and customers to use non-cash means of payment through banks.

4.1.2 Bank and credit institutions inspection and supervision

During the banking reform period, bank inspection and supervision has developed along with the banking legal system. Regulations on banking operations have been updated in line with international practices. The State bank now accepts internal and external auditing as a means to confirm and assess the transparency and objectivity of the information provided by credit institutions. Computer networks, which serve the operations and supervision of banking activities, are linked nation-wide. This has facilitated the supervision of credit institutions and the whole banking system.

The State Bank has developed its supervision approach through the CAMELS system and has also installed information and reporting systems. The role of auditing has also been given greater attention with the General Control Department of the State Bank charged with operational, financial and mandatory auditing for all units of the State Bank, branches of the State Bank at provincial and city levels, and for projects using public assets. For credit institutions, internal control or internal supervision departments have been established and separated through the establishment of the Board of Directors and Executive Boards. Auditing methods have gradually improved through the application of general practices and in accordance with changes in conditions.

However, adequate inspection and supervision has yet to be fully achieved and is underlined by the delay in introducing IAS (or adjusted VAS) which is critical for Vietnamese banks to compete against foreign banks. The lack of IAS has a lot to do with a lack of IAS implementation plans and also effective monitoring mechanisms. Greater effort is needed for more effective supervision of banks at all levels.

4.1.3 Monetary market development

The State Bank has developed a legal framework for the monetary market that meets international standards. In 2001, the Bank has issued regulations on the operation of the inter-bank market and has also issued regulations on money brokerage and monetary market tools, especially tools involving risk management. Further regulations on services/products in the monetary market, particularly in dealings between the State Bank and credit institutions, are likely to be issued in the future. These would include regulations on open markets, discounting, re-discounting, loan guarantee by valuable notes, mortgages, treasury and governmental bond auctions, and valuable note underwriting.

The market developed since 2001 with higher revenue from the inter-bank market and with transactional methods being developed in line with international best practices. Treasury bonds have been auctioned through the State Bank and the volume of market priced treasury bills has increased significantly over the years.

4.2 International Obligations and Liberalization Commitments in Banking Services

4.2.1 The Viet Nam - US Bilateral Trade Agreement (BTA)

The Agreement between Viet Nam and the United States of America on Bilateral Trade Relations (BTA) came into effect on 11/12/2001. The BTA sets out principles and rules governing trade flows between the two countries, including principles and rules for the trade in services. Specific liberalization commitments include eight service sectors[12], with financial services and "banking and financial services" accounting for the longest list of service activities. This fact demonstrates the commitment and determination of the Government to pursue liberalization of financial and banking services.

Under the BTA, the Government of Viet Nam has agreed to comply with the principles and rules of general application and has agreed to commitments on market access and national treatment which will lead to banks and financial companies from the USA benefiting from increased market opportunities in the Vietnamese financial sector. This includes:

Most-Favored Nation (MFN): compliance with this principle, which is actually borrowed from the multilateral trading system (WTO), implies that Viet Nam shall unconditionally give USA services and service suppliers, treatment no less favorable than that it accords to services and service suppliers of any other country. Exceptions include cases where Viet Nam decides to confer or accord advantages to adjacent countries in order to facilitate exchanges across frontier zones of services that are both locally consumed and produced. Other areas excluded include advantages accorded by virtue of Viet Nam's membership in agreements liberalizing trade in services, such as through regional integration[13].

National Treatment and Market Access: These are not principles of general application. As in the GATS agreement, the BTA framework agreement for services outlines a second set of "conditional" obligations that apply only to committed sectors, such as sectors/activities mentioned in the national schedules of specific commitments. Each member specifies the limitations that a member wants to maintain to the principles of market access, as well as the conditions under which it is ready to grant national treatment[14]. By undertaking a market access commitment under BTA, Viet Nam is committed to grant a "treatment no less favorable than that provided the terms, limitations and conditions agreed and specified in its schedule" to the US services and service suppliers. These conditions and limitations can either be discriminatory (only applying to foreigners) or non discriminatory (also applying to nationals but having a quantitative "ceiling" effect on the service). There are six types of conditions and limitations for market access under the BTA: limitations on the number of service suppliers (whether in the form of quotas, monopolies, exclusive service suppliers or requirements for economic needs test), limitations on the total value of service transactions, limitations on the total number of service operations or on the total quantity of service output, limitations on the total number of natural persons that may be employed in a particular service sector, limitation on the participation of foreign capital, and restrictions on the type of legal entity or joint venture through which a service supplier may supply a service.

The commitments undertaken by the Vietnamese Government in favor of US banks and financial companies under the BTA are provided in Appendix 2 and include:

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12 The other seven sectors are: business services, communication services, construction and related engineering services, distribution services, health and related services, and tourism and travel related services.

13 Conditions for this last type of exceptions are described in Article 3, Chapter 3 of the Agreement

14 Indeed, according to Article 7, Chapter 3 of the BTA, in the sectors/services activities inscribed in its schedule in Annex G, and subject to the conditions and qualifications set out therein, each Party shall accord to services and service suppliers of the other Party, in respect to all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and services suppliers.

- American financial service providers are allowed to provide services in Viet Nam through the following legal presence: (i) Branches of American banks; (ii) Joint ventures with Vietnamese banks; (iii) wholly owned US financial leasing companies, and (iv) joint venture financial leasing companies with Vietnamese partners;

- For the first three years under the Agreement, the only legal form apart from banks and leasing companies in which US companies may provide financial services is through joint ventures with Vietnamese partners. This restriction will be eliminated after that;

- After year nine of the Agreement, US banks will be allowed to establish subsidiary banks in Viet Nam. this means from December, 2010, 100% US equity subsidiary banks are eligible to operate in Viet Nam;

- Viet Nam is to allow US banks to hold a stake in Vietnamese equitized banks equal to the threshold imposed on Vietnamese investors[15]. US equity in joint ventures must be between 30% and 49%, before 2010; and

- From December 2004, US bank branches are allowed to: (i) take initial mortgage interest in land-use rights held by foreign invested companies; (ii) use mortgages or land-use rights for the purposes of liquidation in case of default; (iii) access to central bank rediscounting, swaps and forwards facilities; and most importantly (iv) enjoy treatment equal to other local banks.

Viet Nam also committed in the BTA to comply with General Agreement on Trade in Service (GATS) and implement the following commitments:

- The Establishment of wholly-owned subsidiaries of US financial leasing or a joint venture leasing companies, within three years. Since January 2003, non-banking credit institutions in Vietnam are allowed to locate their branches and representative offices anywhere within the country, if these organization have operated in Viet Nam for more than two years and have a due debt ratio less than 5%; and

- Viet Nam will permit US banks to provide deposit services in Vietnamese dong, credit cards, automatic teller machine and other products and services.

4.2.2 ASEAN Free Trade Agreement (AFTA)

The ASEAN Free Trade Agreement requires Viet Nam to commit to a process of tariff reduction by 2006. The reduction of tariffs is expected to result in increased foreign trade activities, greater intra-regional foreign investment flows, and consequential financial support services, such as foreign exchange and international settlement.

While the impact of AFTA on the banking sector will be indirect, ASEAN countries adopted an ASEAN framework agreement on trade in services (AFAS) in December 1995. AFAS provides the broad guidelines for ASEAN Member Countries to progressively improve *Market Access* and ensure equal *National Treatment* for service suppliers among ASEAN countries in all four modes of services supply. All AFAS rules are consistent with international rules for trade in services as provided by the *General Agreement on Trade in Services (GATS)* of the *World Trade Organization (WTO).* Liberalization of trade services under AFAS will be directed towards achieving commitments beyond Member Countries' commitments under GATS, known as the *GATS-Plus* principle.

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[15] At present, foreign owned banks are allowed to hold a maximum of 10% share of local banks, however, each transaction has to seek permission from the SBV.

Under this agreement, ASEAN countries will negotiate intra-regional services liberalization in a number of sectors, including telecommunications, tourism, financial services, construction, and maritime transport. Furthermore, all countries agree to:

- Eliminate substantially all existing discriminatory measures and market access limitations amongst Member States; and

- Prohibit new or more discriminatory measures and market access limitations within a reasonable time frame (Article III: Liberalization).

ASEAN countries have concluded the negotiations of the fourth package of commitments to implement the framework agreement. For financial services, Viet Nam's commitment was concluded under the second package, signed in April 2002, and are detailed in Appendix 2.

4.2.3 GATS and WTO

The General Agreement on Trade in Services (GATS) was initially negotiated in the Uruguay Round of Multilateral Trade Negotiations and has become an integral part of WTO. The GATS has four objectives: expansion of services trade; progressive liberalization through successive rounds of negotiations as a means of promoting growth and development; transparency of rules and regulations; and increasing participation of developing countries. It is structured with two parts: the short *framework agreement*, which is in many ways similar to the GATT and the *national schedules of specific commitments* that members have individually undertaken as well as their individual list of MFN exceptions[16].

One of the main features of the GATS (repeated in the BTA) is that governments are free to choose which services they include in their schedules, and even within the committed sectors, to maintain limitations on the degree of market access and national treatment they are prepared to guarantee, and that they can also depart from MFN treatment (all foreigners have to be treated alike) provided they list an exception to that effect.

Unconditional obligations

The framework contains five general obligations which apply across the board to all services regardless of whether they are committed to ("unconditional obligations"): MFN, transparency, administrative review, disciplines on monopolies and exclusive suppliers and intergovernmental consultations on restrictive business practices.

- *MFN treatment*: Under Article II of the GATS, members are immediately and unconditionally held to extend to services or services suppliers of all other members "treatment no less favorable than that accorded to like services and services suppliers of any other country". This amounts to a prohibition, in principle, of preferential arrangements among groups of members in individual sectors or of reciprocity provisions which confine access benefits to trading partners granting similar treatment. Derogations are possible in the form of article II-exemptions. Members were allowed to seek such exemptions before the Agreement enters into force. New exemptions can only be granted to new members at the time of accession or, in the case of current members, by way of a waiver under Article IX:3 of the WTO Agreement. All exemptions are subject to review; they should in principle not last longer than 10 years. The GATS allows groups of members to enter into economic integration agreements or to mutually recognize regulatory standards, certificates and the like if certain conditions are met.

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[16] This description of GATS has been used in studies undertaken in the framework of the "Trade in Services" Project (VIE/02/009), and has been worked out by the Project in consultation with Mr. Pierre Latrille, from the WTO Secretariat

- *Transparency:* GATS Members are required, *inter alia*, to publish all measures of general application and establish national enquiry points mandated to respond to other member's information requests.

- *Other generally applicable obligations:* Other generally applicable obligations include the establishment of administrative review and appeals procedures an obligation for members to ensure that monopolies and *exclusive suppliers* do not act in a manner inconsistent with MFN and intergovernmental consultation procedures on restrictive business practices by services suppliers.

Conditional obligations

As in the case of the BTA, the GATS framework agreement contains a second layer of obligations that are triggered only for committed sectors, such as sectors mentioned in national schedules of specific commitments[17]. These are market *access, national treatment, freedom of international payments and transfers* as well supplementary obligations on *transparency*[18] and on the *behavior of monopolies* and exclusive services suppliers[19].

- *Market Access* - In their schedule of specific commitments, each member specifies the limitations that a member wants to maintain to the principle of market access. By undertaking a market access commitment, a WTO member grants "treatment no less favorable than that provided under the terms, limitations and conditions agreed and specified in its schedule" to services and services suppliers of any other WTO member. These conditions and limitations can either be discriminatory (only applying to foreigners) or non discriminatory (also applying to nationals but having a quantitative "ceiling" effect on the service). There are six types of conditions and limitations for market access:

  - *limitations on the number of services suppliers*: such as a limited number of licenses for all banks including nationals or only for foreign banks, expressed in absolute numbers, in percentages or through an "economic needs test" that is to say a case by case authorization procedure subject to more or less specified criteria,

  - *limitations on the total value of service transactions or assets*: such as a market share in value or a limited number of banks,

  - *limitations on the total number of service operations or total quantity of service output*: such as a market sharing provision expressed in the amount of capital to accept deposits,

  - *limitations on the total number of persons that can be employed by a services supplier*: such as the number of foreign bank employees,

  - *limitations on the type of legal entity*: prohibition or imposition of certain legal forms such as subsidiaries, branches, representative offices or joint ventures,

  - *limitations to the participation of foreign capital*: say foreign participation in banking companies limited to 49 %.

- *National Treatment* - In a GATS context, national treatment means that in any sector included in its Schedule of Specific Commitments, a Member is obliged to grant foreign services and service

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17 Under GATS, services are divided into 12 industries and 155 sub-industries with four “modes of supply”.

18 Members must notify WTO once a year of any new or changes to existing regulations significantly affecting trade in committed sectors

19 These suppliers should not act in a manner inconsistent with commitments nor when competing in an area outside its monopoly and covered by commitments abuse their monopoly position.

suppliers treatment no less favorable than that extended to its own similar services and service suppliers. The key requirement is to abstain from *measures which are liable to modify, in law or in fact, the conditions of competition in favor of a Member's own service industry*. Members are entitled to make the extension of national treatment in any particular sector subject to conditions and qualifications. Unlike market access there is no *exhaustive list* of national treatment limitations. Every measure has to be tested to see if it affects the conditions of competition in favor of nationals. If the measure fulfils the test then it is a national treatment restriction, and should be scheduled if the member wants to maintain it. The practice has enabled the identification of *typical national treatment restrictions, nationality requirement, effective residency requirement, land ownership restrictions, subsidies reserved to nationals.*

Under GATS, for both market access and national treatment, commitments and limitations are in every case entered with respect to each of the four modes of supply[20], which are:

- Cross-border supply (mode 1): the possibility for non-resident service suppliers to supply services cross-border into a member's territory.

- Consumption abroad (mode 2): the freedom for the member's residents to purchase services in the territory of another member.

- Commercial presence (mode 3): the opportunities for foreign service suppliers to establish, operate or expand a commercial presence in a member's territory, such as a branch, agency, or wholly-owned subsidiary.

- Movement of natural persons (mode 4): the possibilities offered for the entry and temporary stay in a member's territory of foreign individuals in order to supply a service.

In both Market access and National treatment, there are five options to list commitments for each mode of supply:

- *None:* means full liberalization or full market access is granted.

- *Unbound:* means no commitment with a member keeping complete regulatory freedom.

- *Listing an existing restriction* such as a 49% foreign ownership limitation.

- *Partial liberalization:* Using the opportunity of GATS negotiation to liberalize partially while keeping a restriction, such as a 51% foreign ownership limitation to push the ceiling of legislation up by two percent, allowing a majority ownership.

- *Margins:* Keeping a certain margin in terms of action and negotiation for the future, such as binding to 30% while practicing 49%, leaving a country the possibility of tightening its legislation up to a ceiling of 30% and provides a margin of 20% for future GATS negotiations.

MFN Exemptions

MFN is a general obligation that applies to all measures affecting trade in services. However, it has been agreed that particular measures inconsistent with MFN obligations can be maintained, in principle, for not more than 10 years and subject to review after not more than 5 years. Such measures must have been specified in a list of MFN exemptions. The offers of the Vietnamese Government with regards commitments under the BTA are provided in Appendix 2

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[20] This is also the case for under BTA and AFAS

4.3 WTO Accession and Future Forecasts

Viet Nam submitted its application for WTO membership immediately after the establishment of the organization. Since then, the country has participated in nine sessions of the Committee on Viet Nam's accession to WTO. The country has actively engaged in bilateral and multilateral negotiations, responding to more than 1,500 questions from WTO members, in order to clarify Viet Nam's policies on economics, trade, services, investment and intellectual property rights.

During the fourth working party, in December 2000, Viet Nam finalised the policy transparency stage and moved to market access issues. The country officially started its bilateral and multilateral negotiations on accession from the fifth working party in April 2002. With regards to the banking sector, Viet Nam has entered into negotiations over initial offers on tax and services policies.

The eighth working party, in June 2003, marked a turning point in Viet Nam's accession bid, with WTO members agreeing to change discussion from "Elements of the Draft Report of the Commission on Vietnam's accession to the WTO", to "Draft report of the Commission on Viet Nam's accession to the WTO" (ninth working party, December 2004). This was an important document for a potential WTO member to discuss. This session focused particularly on banking services, resulting in the fourth offer on specific commitments in services, which covers a wide range of financial and other services and demonstrates the volume and quality of work that Viet Nam had been done to meet membership requirements.

Viet Nam was expected to conclude its negotiations and be included in the list of new members by WTO's sixth session of the Ministerial Conference in Hong Kong in December 2005. However, negotiations had not yet finished with a number of countries by December 2005. Speaking as an observer at the opening of the Hong Kong conference, Viet Nam revealed its strong commitment to the accession process with a view to obtaining WTO membership as early as possible. After more than 10 years of negotiations, Viet Nam has concluded negotiations with 22 out of 27 Members requesting negotiations. Progress has been made with the remaining countries, Australia, Dominican Republic and Honduras, China, Mexico, New Zealand and the US, and negotiations have proceeded to the final stage.

Viet Nam' possible commitments on banking services

During the negotiation process, WTO partners have shown interest in the country's banking sector, and have requested Viet Nam to open the sector. However, these requirements are still "far above and unmatched" with the development level of Viet Nam's banking system, a system which is less developed than many other WTO members. The sector needs a transition period in order to further strengthen and improve itself in an increasingly competitive environment. However, the opening and liberalization of the banking sector is in line with Viet Nam's reforms and strategies.

The BTA implementation process is a crucial period which is helping Viet Nam familiarize itself with practices and also establish good foundations before joining a "common playground" for trade and services at the WTO. Viet Nam has entered a number of commitments in some services before Viet Nam had regulated for them internally[21].

Requirements for WTO accession are becoming increasingly comprehensive and tougher than in 1995. The nearly 20 nations that have joined the WTO since 1995 have had to accept stiff condition to

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[21] An example of this are commitments made for ATMs, which are understood in Viet Nam as money withdrawing machines rather than potentially being an automatic banking services.

join[22]. As a result negotiation partners are demanding Viet Nam come up with commitments that are higher, or at least equal to, those set out in BTA.

4.4 Chinese and Cambodian WTO Experience

Both China and Cambodia are new WTO members who have economies with a number of similarities to Viet Nam. An assessment of the experiences of China and Cambodia in WTO accession would be helpful for Viet Nam in reviewing the country's current status, and to make appropriate moves in the future.

4.4.1 China

In December 2001, China became a member of the WTO after 14 years of negotiations. China's banking sector commitment levels were high, with full liberalization roadmap over a five year period. From 2006, there will be no differentiation in the operations of domestic and foreign credit institutions. Several of China's general WTO accession commitments have important consequences for financial services. These include:

- The uniform, impartial and reasonable administration of laws, regulations and other government measures – applicable at the local and sub-national levels as well as to the central government[23];
- Publication in an official journal of all laws, regulations and other government measures affecting trade in services[24];
- Annual notification to the WTO Secretariat of all laws, regulations, administrative guidelines and other government measures relating to trade in services[25];
- Establishment of an inquiry point to provide information and respond to WTO related questions[26];
- Judicial review available for all administrative actions regarding implementation of all WTO-related laws, regulations and other governmental measures[27]; and
- Regulators separate from and not accountable to those regulated[28].

As for specific commitments in financial services, China made no commitments on cross-border supplies (Mode 1), except for the provision and transfer of financial information, processing of relevant data and software, consulting, brokerage and other supported financial services. China's commitments to banking services relate basically to Mode 3, including:

- Elimination of geographical restrictions on businesses operating in foreign currencies from the date of WTO entry. Restrictions on local currency businesses would be lessened over a five year period, and all geographical restrictions would be removed before December 2006;

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[22] The average committed tax rate of new members is around 10%. China and some other countries have even had to accept a zero per cent tax rate for many industrial and agricultural items. The VietnamNet website quoted comments of Charlene Barshefsky, former US Trade Representative, that "it's difficult for Viet Nam to ask for lower prices if it joins the largest global trade playground. The price that Vietnam has to pay can't be lower than that of China"

[23] Protocol on the Accession of the People's Republic of China, paras. 2(A)2 and 3, WTO DocumentWT/L/432 (23 November 2001).

[24] Ibid, papa 2(C)2

[25] Ibid, Annex 1A, Section V

[26] Ibid, Para 2(C)3

[27] Ibid, para 2(C)1

[28] Report of the Working Party on the Accession of China, para 309. WTO Document WT/MIN(01)/3 (10 November 2001).

- Removal of restrictions on the type of customers allowed to undertake transactions in foreign currencies from the date of WTO accession. China is committed to allowing foreign organizations to carry out local currency business with Chinese companies from December 2003 and with Chinese individuals from December 2006. Foreign organizations, which hold licenses to perform local currency business, are allowed to serve customers in any area regardless of geographical restrictions. However, in order to obtain business licenses to perform local currency business, foreign organizations must have been operating in China for at least 3 years, and have posted profits for two consecutive years prior to application; and

- Ensure that the criteria for granting business licenses in banking service provision are solely prudential with no economic needs tests[29] applied, and no quantitative limits on licenses. Current measures that restrict ownership, operation and types of legal entity, including the establishment of internal branches and licensing, are to be abolished before December 2006, with the main focus being the removal of restrictions on local currency businesses operating beyond 50% in foreign currency.

Despite these commitments the People's Bank of China (PBOC) has issued a number of regulations on the management of foreign-invested banks, effective since February 2002, as well as other control methods. It is also important to note that China has taken full advantage of the WTO principles of "careful methods" in financial services. The PBOC has set conditions for foreign bank headquarters and branches, capital and other conditions beyond international standards. In addition, foreign banks are only allowed to open one extra branch after 12 months operation, resulting in reluctance for banks to establish or expand in China.

Although China accepted relatively open commitments, the country continues to erect barriers stemming market access and foreign bank operations. The barriers should in turn increase the attractiveness of market entry by contributing more capital to local banks. Other major restrictions which Viet Nam should take further consideration to consist of:

- Requirements on maintaining a high serviceable capital, hundreds of millions of *renminbi*, several times higher than international standards. Each branch requires an equal amount of capital to that of a subsidiary bank;

- High capital adequacy requirements, with a ratio of 8% capital on total assets for loans in *renminbi* in accordance with international standards, however the total capital must be counted separately at branch level, thus substantially limiting a foreign bank's ability to lend, and

- The freedom of foreign banks to set interest rates for deposits in US$ is limited. As Chinese banks hold the majority of deposits in foreign currencies in personal accounts, foreign banks will not be able to offer higher rates to attract new customers.

Although reforms were already specified its commitment roadmap, China has implemented its domestic reforms more quickly than its committed plan. Its commitments are relatively high, extensive and more liberalized than many current regional members of the WTO (Thailand, Malaysia and the Philippines). Furthermore, compared to other recently acceded WTO members (Kyrgyz, Latvia and Estonia), China's commitments are more structured in terms of time, and longer in its liberalization transition process. The gradual Chinese approach with rigid requirements on foreign banks has proven meaningful in that, so far, it has not caused any upheaval. At the same time, local banks have been given substantial time to restructure themselves to better compete with their foreign banks.

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[29] Such as defining criteria, procedures for application, guidelines for administration, providing information, establishing duration and review

These lessons should be carefully studied and considered by Viet Nam authorities so that the liberalization process can be successfully planned and realized.

4.4.2 Cambodia

Cambodia is one of the least developed WTO members and has a small and problematic economy. Its major industry, textiles and garments, is faced with shrinking investment and growing competition from other countries in the region. Cambodia paints a grey picture of debt, under-developed banking and financial systems, and unstable politics and society. With these problems in mind, Cambodia considered accession to the WTO to be a "great remedy" for the economy, and an opportunity to improve its image and raise its attractiveness to foreign investors.

After five rounds of negotiation, Cambodia was officially admitted to the WTO at the end of 2003. In return for the membership status, Cambodia had to accept strict conditions, which could have been less stringent if one takes into account the special situation of such an under developed nation. The rigid stipulations included cutting almost all kinds of taxes, removing agricultural subsidies immediately upon accession, with a maximum transition period of six years (it was five years for China).

In banking services, Cambodia offered substantial liberalization commitments. The country imposed no restrictions on National Treatment for Cross-border supply (Mode 1), Consumption Abroad (Mode 2) or Commercial Presence (Mode 3) to any service, be it deposit, loan, payment or transfer, leasing, consultancy, or brokerage. In market access terms, Cambodia has no restrictions on deposits, loans, payments and transfer services through banks. However, it has made no commitments in Mode 3, leasing, guarantees, trade on bank accounts, stock issuance, monetary brokerage, or asset management. Cambodia is also developing appropriate legal documents governing the banking services covered by Mode 3.

As a member of WTO some felt Cambodia should be able to increase its exports of services as well as gaining access to services not available domestically. In the banking sector, it is also felt that Cambodia will gain from liberalization, as the country will get access to a wider variety of services, mainly offered locally, by foreign banks or through Mode 1 at competitive prices. However, Cambodia needs to reform its regulatory environment and develop necessary human and physical capital to cope with such challenges.

It is difficult to confirm at this stage whether the above perception and benefits are valid, and whether the political will to make real reforms in the regulatory environment and develop human and physical capital exist in Cambodia. It is possible that the generally liberal stance adopted in Cambodia to welcome foreign involvement in the finance and banking sector may hamper the development of local firms. Some feel that there will be a number of costs that will occur immediately after liberalization and that the benefits will come later and that the Cambodian economy may be worse off in the short run, but that in the medium to long term, the gains from liberalized trade will outweigh the short-run adjustment costs.

5 Competitiveness Analysis of Vietnam's Banking Sector

This section presents a competitive analysis of the banking sector in Viet Nam based on data collected from in-depth interviews and survey questionnaires. We have taken two analysis approaches, the Diamond model and the Strength-Weakness-Opportunity-Threat (SWOT) model. The diamond analysis looks at firm rivalry, strategy, competitors, demand conditions and supporting services. The SWOT analysis assesses overall strengths, weaknesses, opportunities and threats faced by the banking sector in Viet Nam.

The analysis aims to address the following issues:

- The level of competition among banking services and the basis of competition;

- Identify possible competitiveness improvements of the banking sector, notably inter-relations between foreign banks; and

- Solutions to secure and expand coverage, quality, price, and diversity of banking services.

5.1 Competitiveness Analysis using the Diamond Model

This analysis looks at factors within the business environment through the lense of a Michael Porter model looking at four factors:

- *The banking environment, strategy and competitors*: strategic decisions of banks generally have impacts on their future competitiveness and a healthy banking structure and a high concentration of competitors will develop the competitive advantage of individual banks as well as the whole sector in general. Synergized competitiveness will enable banks and the whole banking sector to compete with external rivals in the integration process;

- *Supply conditions:* the effectiveness, quality and specialization of inputs, which financial institutions use in their operation to acquire human resources, capital, facilities, technology and science;

- *Demand conditions:* in the context of Viet Nam, the sophistication of demand for banking services will orientate competitiveness, diversity of services and the sector's technology level; and

- *Relevant and supporting industries:* also influence the banking sector's competitiveness through the supply of inputs for the banks. The availability and development of supporting industries including telecommunication, information technology and auditing will increase the productivity and competitiveness of banking services.

5.1.1 Banking environment, strategy and competition

In recent years, the business environment for banking services has improved with increased orientation towards the liberalization of banking services and financial markets in the legal environment. This is clearly demonstrated in the following areas:

In terms of structure and institutions: In the 20 years since "doi moi" the banking and finance sector has moved from a mono-tier banking system to a two-tier system with the strong growth of various financial institutions, including commercial banks and non-banking credit institutions under a variety of ownership. This ownership diversity has facilitated a more creative and effective environment for banks to operate.

In terms of operation and management: Other reforms have also aligned with and benefit from the two-tier banking structure and a market economy. Monetary policy has become an independent tool to intervene at the macro-level, to control inflation and encourage economic growth. The formulation and management of monetary policy based on market principles has been adopted by SBV to achieve macro economic targets. Indirect tools of monetary policies such as re-discount open market practice; SWAP, etc have replaced direct monetary controlling measures and Interest and exchange rates have basically been liberalized. They now fairly reflect the value of Vietnamese currency and correspond to changes in local and international monetary markets. Interest rates are being gradually liberalized and intervention has moved from multiple fixed exchange rates to a flexible exchange rate corresponding to market conditions. Banking inspection and supervision gradually follows international practices and standards, such as CAMELS and BASEL.

In terms of legal framework for credit institutions: In recent years, a legal framework has been built that supports sound operation and fair competition of credit institutions and which is sustainable. Commercial banks are given more autonomy and responsibility and are allowed to set borrowing and lending interest rates. Directed lending or policy lending under the Government's patronage has gradually been separated from commercial lending. Commercial banks are also increasingly applying international best practices such as: accounting, payment, risk management, investment, money exchange, debt classification and risk back-up.

These areas have helped support an increasingly favorable environment for banking business and its sustainability and effectiveness. However, a number of less favorable conditions continue to affect the banking sector environment. The Vietnamese economy is still developing and has a low level of service diversity, poor quality and low competitiveness, poor application of high technology to generate value and productions. This includes:

- A total asset/GDP far lower than that of any other regional country (2003: 54% in Viet Nam, Thailand: 145%; Malaysia: 193%; and China: 211%);

- The Vietnamese economy continues to be based on cash, with M2/GDP ration being 62.4% and the cash/GDP ration being 15% in 2003.

Table 5: Regional Comparison of M2/GDP (%)

Country	2000	2001	2002	2003
Viet Nam	44.6	52.1	53	62.4
Malaysia	103.5	108.4	106.3	108.7
Thailand	105.6	103.7	99.2	96.7
Indonesia	59.1	58.2	54.9	59.4
Philippines	61.6	58.2	58.7	56.1
Singapore	108.4	118.9	115.8	-
China	152.2	158.6	182.4	191.6

Source: IMF, July 2004

Table 6: Regional Comparison of cash/GDP

Country	2000	2001	2002	2003
Viet Nam	11.8	13.8	13.9	15.0
Malaysia	6.5	6.6	6.6	6.7
Thailand	8.3	8.6	9.1	9.2
Indonesia	5.7	5.3	5.0	5.9
Philippines	5.7	5.3	5.5	5.5
Singapore	7.2	7.8	7.9	-
China	16.4	15.9	16.9	16.9

Source: IMF, July 2004

The dollarization level of the economy remains high, 23% in 2003[30] and the domestic credit/GDP ration is low, 52.5% in 2003. There are a number of reasons for this, with low income levels, USD420 in urban areas and USD350 in rural areas, people may not be interested in banking services and also rely on cash for their daily transactions. At the same time Vietnamese citizens habits and culture continue to restrain the use of banking services.

Table 7: Regional Comparison of domestic credit/GDP

Country	2000	2001	2002	2003
Viet Nam	351	39.7	44.8	52.5
Malaysia	148.2	155.5	154.2	152.9
Thailand	121.3	111.5	116.4	112.8
Indonesia	67.4	62.7	59.5	61.8
Philippines	62.3	58.0	55.9	55.1
Singapore	65.5	80.3	65.8	-
China	132.9	136.8	170.3	178.8

Source: IMF, July 2004

A further factor holding back banking services is the incompatibility between institutions and the regulations that govern them, such as regulations on foreign investment, taxation, land and banking. Many regulations in the banking sector have not been unified and affect the businesses operations of banks. Regulations have not kept pace with the framework for regulations and institutions[31]. The majority of the activities required to facilitate the integration process have not been regulated, including those governing indirect foreign investment. The banking sector continues to lack a number of basic regulatory requirements which enable banks to develop international standards, such as regulations on international payments and e-banking, information confidentiality and transparency. Demand conditions for banking services

At present competition is not confined to 'traditional' banking services (deposits and loans) but also to the provision of new services between domestic and foreign providers. In the future demand for banking services is likely to increase as:

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[30] If calculated in USD as percentage of all deposits the figure is 31% by end of 2004

[31] When the BTA with the US and Japan came into effect, the Law on Financial Institutions needed to cover 100% foreign ownership of financial institutions.

- demographics and population increase, especially in urban areas, and adapt to urban lifestyles, banking services will be in higher demand;

- an increased number of Vietnamese nationals will work overseas resulting in demand for monetary transfers via banks;

- domestic incomes rise there will be an need for the development of banking services;

- growing economic investment and cooperation between Viet Nam and other countries and the growth of Vietnamese enterprises will lead to rising demand for banking services; and

- ongoing infrastructure development, especially in telecommunications, will enable more diversity in banking services and in the development of banking services.

The development of the economy, technology, living standards, and impacts from globalization will stimulate different needs in banking services. Moreover, in response to a more competitive market, customers will develop higher levels of sophistication concerning products and services.

5.1.2 Supporting and related industries

Growth in the banking sector depends on the development of other sectors, such as information technology, telecommunications, education, and transportation. The role of the banking sector in the country's economy also relies on the related industries such as the insurance and capital market. A developed insurance and capital market that has close linkages with banks will no doubt facilitate the growth of the banking sector[32].

A number of Insurance companies, with a variety of ownership forms, now offer a diverse array of services, including 22 services on voluntary health insurance, various accident insurance options, 12 life insurance services, 39 asset insurance services, and 11 liability insurances. Besides locally operating insurance companies, there are 21 foreign insurance company representative offices[33].

Viet Nam's capital market has also grown in recent years, particularly after the establishment of the Ho Chi Minh City Stock Exchange in July 2000. By December 2005, 33 companies were listed on the stock exchange, with a capitalization of VND 44,600 billion (US$280 million)[34]. Most of these companies are equitized companies transformed from state-owned enterprises, who own an average of 16.68% in each of these firms. At present, there are 15 foreign investors and about 200 domestic investors operating in the Viet Nam Stock Exchange. In addition to the small formal market there is also a large volume of shares that originate from another 2,000 joint stock companies and 36 joint stock commercial banks that trade on the over-the-counter market (OTC).

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[32] A separate study on insurance services is available from this project, VIE/02/009

[33] Two British, two from Korea, four from Japan, one from France, two from Singapore, four from Taiwan and six from USA.

[34] Đầu Tư Chứng Khoán No.7 dated 13/2/2006, page 3

Table 8: Proportion of total assets of financial intermediaries

#	Financial intermediaries	Year 2002 (%)		Year 2003 (%)	
		Percentage of total assets	Percentage of total assets and GDP	Percentage of total assets	Percentage of total assets & GDP
1	The banking system	8.9	43	82.3	52
2	Insurance companies	2.6	1.3	2.7	1.35
3	Stock Exchange	3.4	1.65	3.7	2.3
4	Investment fund	10.3	5.3	9.7	6
5	Other financial intermediaries	1.8	-	1.6	-
	Total	**100**		**100**	

Source: Calculation of IMF in Viet Nam and extracted from SBV document; Report in seminar of Ministry of Finance

A directly supporting industry of the banking sector is information and communication technology, which has developed extensively in recent years. ICT has brought a number of benefits to the banking sector. Global connection has enabled banks to develop card payments services (Master Card, Visa Card; Diner's Club), and money remittances (Western Union). Several commercial banks have established card centers, through which payment transactions and real estate trading are facilitated. There are three types of networks in the local bank market: (i) the ATM pyramid network, operated by Vietcombank and several joint stock commercial banks and branches of several foreign banks; (ii) BankerNet, operated by three state commercial banks (BIDV, Incombank, and VBARD) and several joint stock commercial banks; and (iii) networks between joint stock commercial banks and foreign banks.

Education and human resource development also play a crucial role in the banking sector. In building human resource capacity for the sector, a network of both formal and informal training institutions is available. This includes state universities such as National Economics University, National University, the Finance Academy, and also schools, institutes and training centers specializing in banking, such as the Banking Academy, the Bank Training Center. Training has changed and improved to meet the needs of the banking sector with new content being added, particularly new practices in financial and banking operations, as well as international best practice.

In the past the operations of other industries and the banking sector, including the insurance sector and the stock exchange, have not been synergized but have still managed to reduce production costs. This can be seen in the isolation of operations between such organizations and the limited interactions of the inter-bank monetary market.

Table 9: Ranking on development of financial market

#	Country	Development of stock market	Development of bonds & security	Stock exchange
1	Viet Nam	52	51	50
2	China	53	49	44
3	Singapore	10	28	26
4	Malaysia	32	45	39

5	Thailand	44	42	32
6	Indonesia	50	38	41
7	Philippines	40	41	33

Source: Viet Nam Banking Association (2003) and ADB

5.1.3 Factors and conditions of the banking sector

Financial capacity

The operating capital of Vietnamese banks is limited, with a low quality asset portfolios and substantial bad debts according to IAS. Most JSBs operate on a small financial scale, and the limited ability of SOCBs to resolve NPLs has created difficulties. The capacity of Vietnamese banks to deal with risk is questionable, especially when coupled with poor management capabilities. SOCBs' low level of equity leads to many difficulties, particularly in raising capital to achieve a capital adequacy ratio of 8% in the short term, mostly due to a high level of bad debt. Their capacity for internal accumulation is also weak, and the possibility of state recapitalization is limited. At the same time, credit demand is growing quickly, 25% per annum since 1998.

Table 10: Scale of banks in Viet Nam

Indicators	2000	2001	2002	2003
Total assets of all banks (billion VND)	279,884	306,218	334,017	371,318
Total assets per GDP (%)	63	57	58	54

Source: Extracted calculation from IMF and annual report of the World Bank

Information Technology, information and management

Vietnamese banks have not formulated proper and effective risk management and internal payment mechanisms, supervision and auditing systems are also ineffective. Information management, accounting and financial management systems are considered well below international standards. The limited financial capacity of Vietnamese banks has limited their ability to invest heavily in technology.

Foreign banks operating in Viet Nam are mainly major international players with modern banking technology and advanced products. Due to limitations imposed on their network expansion and enforced small market share, foreign banks have to make careful cost-benefit analysis. When it comes to products which are heavily dependent on international networks, the foreign banks win out as their parent bank may already own a global network which they are able to link to without occurring great expense.

Human resources

Human resources are a problem for Vietnamese banks. While numerous in quantity, their expertise in local and international laws and WTO principles is insufficient to meet the requirements of a modern banking system and international integration. Laws and policies on labor in Vietnamese banks create further constraints. In particular, there is no appropriate system to attract and develop a pool of highly skilled employees. Organizational structures within Vietnamese banks are still cumbersome and irrational, inhibiting modernization and application of the best practices in corporate governance.

Foreign credit institutions, on the other hand, enjoy the advantage of attracting staff that are professionally trained and have international experience. Increased investment in staff training, particularly overseas training, and reasonable incentive policies made by local banks have helped them to attract and retaining qualified staff.

5.2 SWOT Analysis

In this section of the paper, we analyze the strengths, weaknesses, opportunities, and threats to the banking sector in Viet Nam as a whole, rather than to individual banks. The distinction between the SWOT features of the banking sector are not always clear with challenges actually being opportunities for the right bank. As foreign banks are expected to become increasingly important in terms of share, transaction volume, contribution to intermediation, and a catalyst of competition, they are also an integral part of the system, and their strength would also consolidate systemic soundness.

5.2.1 Strengths

Stable macroeconomic environment

The macroeconomic environment in which banks operate is stable and sound. As economic growth has been robust and sustainable with low inflation, and the regulatory environment has become more business friendly, banks can perform their intermediation function in a stable environment. Thanks to such macroeconomic stability, banks can mobilize a growing amount of deposits to finance trade and investment, make profit and expand their network to serve more people. After 10 to 15 years of development, the Vietnamese banking system has developed strong networks, customer knowledge, and confidence. The capital market has also started take off again due to Viet Nam's stability and macroeconomic fundamentals and the removal of some restrictions. It is now easier for banks to issue shares, which helps them increase their capital and add to the systemic soundness and safety. Growing bigger has also helped banks take advantage of economies of scale and become more competitive.

Strategic partnering

There is variation in size, age, capital, know-how, and experience among SOCBs, JSBs, foreign banks, and other credit institutions. Local banks have lower costs in setting up branches and thus expanding their network. They have better knowledge and information on local customers, which often substitutes standard financial statements for lending purposes. This has helped them lend to SMEs, a significant segment of the market which few foreign banks would be interested in, in the short term. SOCBs' advantages include their market share, long standing presence in the market, extensive networks, public confidence, and government back-up. JSBs, though established later and of a smaller size have also performed successfully especially after restructuring, with some mergers and acquisitions. Their strength includes flexibility, autonomy, pure profit orientation, and adaptability.

With BTA and coming WTO commitments, more foreign ownership in local banks will be allowed. JSBs have been very fast in capturing this opportunity with several selling shares to foreign banks to increase their capital base and acquire expertise and know how. If JSBs continue to go into strategic partnership with foreign banks Viet Nam can expect stronger and more professional banks, and more competitive banking services. Foreign banks, despite their small market share, have a high quality portfolio, contributing a great deal to trade finance and FDI facilitation. Their products, if launched in Viet Nam, will have been tested and proven elsewhere raising their chances of success.

Market positioning

The combination of different banks ownership forms and their complementarities strengthens Viet Nam's banking sector and capacity for further development in a more liberalized and integrated market, despite the challenges they face. Though larger banks are considered stronger and more competitive, smaller banks do have their own advantages. Smaller banks are closer to customers and know them better. Their loans have relatively lower risk. In Viet Nam a number of small banks and credit institutions are quite successful without government subsidies or support from serving a particular group of customers. There exists a model of mobilizing deposits from the public to lend to a particular group of borrowers whom the credit institutions know very well and then use social pressure from the borrowers to secure repayment. This model has proved successful in rural area and should be considered for further expansion in areas not served by large or foreign banks.

5.2.2 Weaknesses

Weaknesses of the banking sector in Viet Nam include institutional, structural, financial, and technical weaknesses.

Institutional

The most obvious institutional weakness is the lack of a legal framework that should protect a bank's interests as creditor in the case of default. Court decisions in loan default cases rarely take into account a bank's interests or their creditor's rights. This problem is even worse for foreign banks. This hinders intermediation efficiency and increases the cost of lending, as banks have to make higher provisions for expected loan losses.

The second institutional weakness is the existence of the non-commercial, subsidized, or preferred credit currently provided by the Social Policy Bank and the Development Assistance Fund under the government sponsorship. While the separation of policy lending from SOCBs was the correct move from the government, transparency in expenditure for policy purposes remains an issue. For the Development Assistance Fund, the concern is about efficiency and commercial viability of the projects that receive favorable funding terms and the project appraisal process. Preferred credit is only justifiable if funded projects are selected on a very careful cost-benefit analysis, taking into account the opportunity cost of capital. For a poor and capital scarce country like Viet Nam, this is even more important. The appraisal of funding decisions requires a high level of transparency. A lack of transparency in fund allocation leads to fund misuse, inefficiency, and distortion of the capital market. Lending at favorable terms to politically desirable, rather than economically justifiable, projects affects the competitiveness of all market players.

Directed lending by SOCBs, though reduced in scope, is still cited as an on-going issue. This will risk perpetuating the problem of bloated NPLs in SOCBs, which in turn will hinder the equitization process.

The lack of transparency in corporate customer's financial statements is another institutional weakness. Very few firms are independently audited[35]. The lack of transparency in auditing and accounting makes it very difficult to assess a firm's profitability and lend productively, preventing a bank from doing business with firms. This also explains why foreign banks mostly lend to large firms, rather than SMEs. Capital market development would help resolve this issue. If firms go public, their financial situation has to be disclosed and transparent, making it easier for banks to lend and for firms to borrow.

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[35] According to Decree 105/NĐ-CP and Circular 64/TT-BTC, SOEs are required to conduct independent audit of their financial statements as from 2004

Structural

The majority of structural problems within the banking sector are found in SOCBs and are due to their relationship with the government. SOCBs continue to be treated differently and are subject to different governance regimes compared to remaining banks. They are accountable to the government as their owners, but in return enjoy certain benefits. All decisions on changes of capital, investment, appointment, personnel, salary, business plans, etc. are subject to government approval, slowing down SOCBs business decisions, adversely affecting their flexibility and adaptability in a competitive environment. SOCBs also receive free office buildings and other benefits from the government which are not accounted for as business costs, while their owner, the government, does not pressure for profit. In some markets, such as lending to large government projects, or directed lending, they do not face any competition. They are also permitted to bend some of the governments own regulations especially where they lend to government sponsored projects that are so large, no one bank can lend if it had to comply with the rule of not lending to one customer in excess of 15% of it's total assets. Government approval for exemption to this restriction is sometimes provided for such projects and loans from SOCBs. It is clear that in a market where dominant players, with 75-80% of market share, are treated and required to do business on a half market-basis, the system has a structural problem.

The pilot equitization of SOCBs, before mass implementation, was identified recently as a solution to this structural problem. It will also improve banking competitiveness and systemic soundness. There are parts of SOCBs that are quite attractive to non-state buyers, including foreigners. The challenge is how to separate the good part from the bad and how to deal with the latter. Most SOCBs still have NPLs for which no radical and effective solution has yet been found. NPLs, redundant staff, unprofitable but politically desirable activities and branches are problems to be faced before SOCB equitization, though equitization appears sometime off. There remains a lack of a long term vision, strategy, and objectives for equitization, with ideological concerns still there. Stakeholders may not be comfortable with or ready for this jump. Most banks still struggle with immediate problems and do not have a clear long term strategy in mind. On the other hand, the pressure of international commitments and integration makes it imperative that something is done about these state-owned credit institutions.

JSBs are in much better shape in terms of asset and portfolio quality, having more autonomy and a clearer profit orientation. However, given the market size of Viet Nam, they are too many in number and are sharing too small a market. Except for the few largest JSBs, most are too small in size, making them uncompetitive due to their lack of economies of scale and large fixed cost investments in technology upgrading. To be competitive, JSBs need to be financially large enough and need consolidation to increase their size and reduce their number from the 29 current JSBs to 14-15.

In terms of lending opportunities for all banks, international experience shows that lending to medium sized firms is most efficient, desirable, and profitable for banks. However, these medium sized firms seem to be missing in Viet Nam. Equally there are only a few hundred large and mostly state owned corporations that most JSBs are unable to lend to. There are also tens of thousands of potential SME clients, which banks only find the bigger ones desirable, profitable, and of a lower risk to lend to. This market structure severely restricts bank's opportunities to lend and to make profit.

Financial

In terms of financial weaknesses, independent auditing results indicate that Vietnamese banks are financially unsound, especially SOCBs, and have a worse profitability and cost indicators than the region's average. Given their limited financial capacity and the huge demand for credit of the economy, banks barely meet the demand for short term loans and cannot provide enough medium to long term loans. Since the stock market is yet to fully develop and firms are not ready in terms of financial transparency to borrow there, banks remain the only choice for medium to long term funding. More than 80% of firm's financing currently comes from bank loans, with 25% of short-term funds of banks are allocated to long terms loans, increasing systemic risk. The capital market should be developed further to provide medium to long term finance with banks only provide short term funding.

The NPLs accumulated by the 4 largest SOCBs are the worst financial weakness in the system. Some sources indicate that if NPLs were classified by international standards and provisioned for accordingly, some banks would have zero net worth or profits.

Despite their poor financial capacity, local banks, especially JSBs are engaged in price competition by squeezing their interest spread so much that it might put the bank at risk, given the significant default rate and limited access to collateral in Viet Nam. This interest rate competition could possibly weaken them all. If the financially stronger foreign banks start their expansion with aggressive marketing campaign, backed up by financial resources (as expected by local bankers), this race to the bottom by local banks simply cannot be sustained.

Technical

Technical weaknesses are reflected in poor management skills, credit analysis, risk management, low technology, lack of standardization of service quality throughout the network, and lack of modern governance structures in local banks. Due to limited technical capacity, banks mainly provided and earned income from traditional and basic credit services up until 2003. Non-credit services only started quite recently when the more advanced banks became aware of foreign competition under liberalization and invested extensively in upgrading technology. Compared to banks in more advanced market economies, the commercial banking sector in Viet Nam is young, and is only now starting to learning about services that have been provided elsewhere for many decades (such as loans mortgaged against inventories). Most products offered by Vietnamese banks are primary and basic. Derivatives products are a new phenomenon known only since the early 2000s. A lack of accounting standards for these financial instruments in existing Viet Nam Accounting Standard is one cause of delay in introducing these instruments, constraining banking service development.

In terms of human capacity, few bank managers have acquired formal training in this profession, with most having to learn by doing or obtaining on-the-job training. Limited human capacity in risk management will severely restrict a bank's capacity to handle the growing volume of transactions and the associated risk.

The lack of a modern governance structure and customer service procedures is also affecting bank competitiveness. Loans take a substantial amount of time to be processed through the different and sections of a bank. In many banks, including very advanced ones; customers have to wait for a long time, going to different windows before a transaction is completed.

5.2.3 Opportunities

A larger and level playing field

Based on trade theory, overall benefits of liberalization outweigh their costs and create a win-win situation. This also applies to banks. Trade liberalization through international integration and commitments through BTA and WTO accession will give greater market access for Vietnamese exports and attract more FDI into the country. As trade, FDI, and overall economic activities expand there will be more demand and opportunities for banks to lend while mobilizing more savings. With increased and vibrant economic activities, more firms make profits increasing their, capacity to repay loans, which is good for banks. Banks' portfolios and assets will have a higher quality helping them to access the capital market to raise more equity and become bigger. This has already happened for some good JSBs. The market for banks will become bigger, and more players will enter to share it.

BTA implementation and WTO accession will set a time frame for businesses to anticipate competition, make rules more transparent, and create more level playing fields. Increased transparency will result in better ratings for Vietnamese borrowers, and lower risk premiums charged by lenders, including banks. A greater number of SMEs will grow bigger as will their demand for credit. As incomes rise there will be opportunities for consumer lending, which is expected to double over the next 5 years. The capital market is also expected to develop fast to provide a long term funding channel for firms, and there will be less pressure on banks for funding. Banks will focus on short term credit, consumption lending, individual borrowers, SME lending, and non-credit products, instead of substituting the capital market for long term funding.

In brief, the macroeconomic picture in which banks operate will be bright and promising with trade liberalization. If banks are well prepared and start actions early, they can capture these opportunities.

Foreign bank entry

When restrictions on foreign ownership in local banks are relaxed, as committed in the BTA and WTO offers, foreign banks can buy shares in local banks and become strategic shareholders who can make local banks stronger and more competitive. Mergers and acquisitions will also take place between domestic banks and foreign banks making banks bigger in size and more competitive.

A number of foreign banks have already entered the Vietnamese markets through share purchases of local banks, with others under negotiations. This is sure to increase in the future. This provides a quick opportunity for both sides to learn and complement each others' strength. Foreign banks can introduce new products through the existing network of local banks; apply their risk management procedures in local banks, while local banks will have access to more finance for expansion. Allowing a foreign bank to have a stake in a local bank also improves the credibility of the latter in the eyes of other investors and the public at large. Banks with such mixed ownership are likely to target the retail banking market, some may target the wholesale market, and all will expand into other services.

Foreign bank entry will bring more capital into the economy and increase the level of competition on local banks. The BTA and coming WTO membership already sends a strong positive signal to local bankers. From 2003 local banks, especially the stronger JSBs became aggressive in network expansion, marketing and the launch of new products, which give customers more choice and better quality services. This is really an encouraging outcome which will continue further under liberalization.

Increasing demand

Demand for credit remains large on the lending side, while there remains a substantial amount of savings outside the banking system. This creates significant opportunity to mobilize further savings for banks. More developed banking would reduce the cash economy; make the system more transparent, easier for income disclosure, taxation, as well as fighting corruption and smuggling. A more developed banking system could also gradually replace the informal credit market as more people have access to bank services.

As banks develop into more non-credit services, their income share from credit will decline and from non-credit services will increase, resulting in changes in banks profit structures[36]. Non-credit services involve less risk for banks.

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[36] Currently 80-90% of bank's income is still generated from credit services. this is expected to fall to 60-80% in the future.

5.2.4 Threats and challenges

Financial sector liberalization without reforming domestic institutions and regulations in advance, can easily result in crisis. This was been proved in the East Asia financial crisis of 1997. Sequencing is important with prudential domestic regulations in place first. At the macro level, when the economy and its financial sector becomes more open and integrated to the world, they are also increasingly prone to external shocks and subject to more volatility and domestic institutions will be necessary to resist shock. At the banking sector level, as the volume of transactions rise in parallel with trade and investment, the management capacity should be concurrently upgraded. Under greater integration managing global volatility becomes the concern of both bank regulators and managers, especially when large banking institutions are financially unsound, which is the case of Viet Nam now. If regulatory and management capacity fails to understand the current situation and anticipate the fast development of financial transactions, it will either loose control resulting in crisis or impose back restrictions to keep everything under control. Either case is harmful for development.

From the market side, public confidence in the banking system remains fragile. The experience of hyperinflation in the 1980s and credit fund collapses as a result of poor management, fraud, and the government's anti-inflation policy package[37] in 1989 have left their mark in the public's memory[38]. Experience has shown that any bad news about bank performances can cause public panic and then a bank run.

Supply side of the banking sector

Challenges from stronger competition and new sources of competition is almost certain. Competition among local banks, between local and foreign banks is now expected. A new source of competition comes from non-bank financial institutions such as insurance, corporate bond and other financial instruments. This kind of competition is mainly on the saving mobilization side and for long term funding. This results in funding costs rising and banks having to search for new sources of funding through new borrowing instruments such as certificates of deposit and more customized saving products.

Competition from foreign banks may vary from one market segment and banking product to another. Currently, foreign banks serve the high end of the Vietnamese market with high quality borrowers, large corporations, FDI related transactions, and the urban market. This may continue but expansion may be seen in other segments competing with local banks. In savings mobilization local banks and regulators expect foreign banks to bring capital in from outside and lend domestically. This may not necessarily be the case. Foreign banks are also looking for access to Vietnamese savings to be able to lend, which they believe are quite significant outside of the banking system. They have good reasons to believe that they will quickly gain trust amongst Vietnamese savers, especially those more sophisticated and well-informed.

Demand side of the banking sector

On the lending side, banks will have to compete for high quality borrowers by offering favorable terms, more features, professional services, low cost, and convenience. Those that fail do so will be stuck with lower quality borrowers rejected by the more advanced banks. In addition, with increased liberalization in goods trade and lower protection, some in industries will lose out, affecting banks that

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[37] The government anti-inflation policy package included the termination of subsidies, sharp increases in interest rates, and foreign exchange rate devaluation.

[38] Viet nam's rural credit cooperatives collapsed in the late 1980s, with a loss of an estimated VND 100 billion in the form of deposits of small savers. Under the supervision of SBV a new system of rural savings and credit co-operatives, now called People's Credit Funds, was established by the government as part of a stated policy to reform and strengthen the country's banking system. One of the most important objectives was to restore public confidence in the formal rural finance system.

lend to them. This is especially true for SOCBs, which tend to lend to import substituting industries and SOEs.

Non-credit service development is safer and generate, secure and stable profits for banks. However, revenue from non-credit services can not grow as fast as that from credit as it takes time to educate customers. Investment in technology and infrastructure for these services is also large, and will not see a return for a number of years. Small banks may not be able to move into this area unless they share infrastructure with larger banks. Most banks' income from non-credit services is placed off the balance sheet, worsening the transparency of financial statements and increasing systemic risks for those banks involved in providing these services, while the regulatory system is unable to keep track**.**

Bank modernization

ICT for banking is developing quickly with banks having to continually upgrade to compete. Data conversion from old to new software is challenging some dawdling banks, especially larger ones, as the data volume to be converted and updated is huge. As a result large and technologically obsolete banks are at a great disadvantage. Investment in IT to strengthen the customer information protection system and technical solutions for international crime in bank account theft and card theft is another growing concern for all banks.

In a more liberalized business environment and more vibrant economy, banks of different ownership types face different challenges. Foreign banks, despite their good credit analysis and risk management skills, are not immune to NPLs, especially when their lending increases after the removal of restrictions. Among local banks, change in management style and corporate governance remains an issue and cannot be addressed over a short period of time. Corporate banking governance in SOCBs is an even greater issue as there is no clear distinction between ownership, management, and regulation. On the one hand, SOCBs are accountable to the Ministry of Finance, which represents the government as the owner, and also are accountable to the SBV, which is the sector's regulator and, in one way or another, manager. There are also rules applied across the board for all government agencies and quasi-government institutions, such as personnel, recruitment, compensation, reporting regime, which SOCBs are not an exception. Past directed lending and strong political interference with the lending decisions in SOCBs, free them from a true level of accountability before their owners should they operate on a truly market atmosphere. The process of appointing Chief Executive Officers (CEO) and Vice CEO positions is also highly politically in SOCBs rather than business driven. The implications are completely different incentives in the governance structure and the bank's business management.

Bank equitization

The biggest challenge for the local banking system is SOCB equitization. Before equitization is possible, SOCBs need to be restructured and deal with their NPLs, not an easy task. When this has been done, a clear objective, strategy, and roadmap is needed for the equitization of each SOCB. As the objective of equitization is to improve efficiency, profitability, governance; to increase capital; to acquire management skills; to become more market-based and profit oriented, one critical question is whether the government still wants to remain as the majority shareholder. The maintenance of state ownership, control, and concern of sovereignty is challenged by SOCB equitization, especially when foreign ownership is involved. Once SOCBs have been sold to non-state shareholders, they will be subject to shareholder supervision and accountable for their performance. There will be no more excuses for high or new NPLs or poor performance. Directed lending, SOE preferences and collateral based rather than commercial viability based lending will also no longer be valid.

A shareholder structure will also determine governance. The question is how to select strategic shareholders who not only bring in capital but also management expertise, know-how, and international experience. Equitized SOCBs may not wish to have mainly individual shareholders whose focus is on dividends and who do not contribute to a bank's strategy.

After equitization, the unprofitable branches in an existing network of SOCBs may be closed down as they are no longer seen as profitable, sustainable or feasible. This raises a concern of equal access for customers in more remote areas where few banks are willing to serve. A gradual approach is expected in banking equitization, in which the government may not leave everything to the market. Dominant government ownership will still be maintained for sometime after equitization with social objectives achieved through government intervention. Another banking model for remote and poor regions is credit funds or mobile banking, which could substitute unprofitable branches.

5.3 Bank Risk Analysis

Banks are highly leveraged institutions with usually a significant duration gap in their balance sheet. Consequently, banks are exposed to a variety of risks that may threat their economic survival. It can be argued that Vietnamese banks are extremely exposed to various risks, much more than should be, and financial integration might boost these risks. Therefore, it is necessary to take into account systemic, financial, and also regulatory risk for Vietnamese banks and the interconnection of these risks with financial integration.

Systemic risk

Dollarization causes currency mismatches in bank balance sheets and in the balance sheet of final borrowers (debt in dollars, revenues in domestic currency). Since 2004 SOCB lending in dollars to SOEs has dramatically increased. A rapid non-anticipating change of the dong/dollar exchange rate would destabilize most Vietnamese banks.

Although the SBV tries to control the maximum volatility of the exchange rate, Viet Nam's exposure to external supply shocks and possible repercussions for the exchange rate has dramatically increased. The Vietnamese economy remains extremely biased towards international trade with a degree of openness of roughly 60 percent. A robust domestic financial intermediation is crucial for the development of a dynamic domestic sectoral growth.

Dollarization of deposits is currently around 31 percent and rising. Deposits at Vietnamese banks, SOCBs and others are implicitly guaranteed by the government. While a central bank can always serve as a lender of last resort in domestic currency simply by printing money, this function is limited in foreign currency, especially as Viet Nam has a low foreign exchange reserve[39].

Foreign banks have an advantage working with dollars as their mother institutes serve as quasi lenders of last resort. In the case of currency depreciation, higher inflation, or a bank run there would be a move from domestic into foreign banks. It is no coincidence that the degree of dollarization of an economy and the market share of foreign banks is strongly correlated.

Regulatory risk

The delayed introduction of International Accounting Standards or better adjusted Vietnamese Accounting Standards is a shelter against foreign competition for local banks. Twenty-six VAS have so far been adjusted with 4 others to be finalized by the end of 2005. However, no further concrete plans for IAS implementation exist for the future.

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[39] The foreign exchange reserve is low relative to import volumes and low relative to the deposit volume in dollars; so systemic risk has significantly increased.

Consequently, insufficient IAS implementation shelters Vietnamese banks from foreign competition as non performing loans are systematically understated. At the same time, systematic risk in the banking sector is accelerating. An example is the most recent use of derivatives, while no Vietnamese accounting standards exist or are in the drafting stage.

Financial risk

Capital adequacy ratios (CAR) for Vietnamese banks are, according to international standards, very low. A proper valuation of recent recapitalization by means of Treasury bonds (non-tradable) and NPL, including directed lending would give an even worse picture. Vietnamese banks, especially SOCBs, are extremely leveraged. In addition the maturity mismatch of liabilities and assets is administrated and unhealthy large. A significant increase of sources of funds would cause a severe margin crunch and might jeopardize survivability of banks.

5.4 Conclusions

The following table illustrates Vietnam's banking sector competitiveness in comparison with other countries in the region:

Table 11: Competitiveness of Viet nam's banking and finance sector

#	Countries	General finance ranking for 2001	General finance ranking for 2003
1	Viet Nam	47	43
2	China	20	21
3	Singapore	3	3
4	Malaysia	21	22
5	Thailand	26	24
6	Indonesia	50	46
7	Philippines	36	34

Source: IMF 2003; WEF

Beside the banking system itself, the following issues will arise during the integration process:

- ***Exogenous risks from international and regional banking systems:*** opening the domestic financial market will increase risks within the market due to external impacts, and will erase the probability of exploiting the gap between domestic and international interest rates;

- ***Economy of scale and customer distribution channels will be lost.*** At present, advantages in market share, customers and distribution channels lie in the hands of domestic banks. However, limitation and discriminatory treatment are expected to be abandoned after 2010. The scale of operation and approaches to the market, customer segments, and the types of services provided by foreign banks will therefore increase. At that point, Vietnamese banks will have to relinquish a chunk of their market share to foreign banks;

- ***Investment in modern technology***. With their limited financial and operational capacity, the modernization challenge has turned into a large pressure. If new banking technology is not planned for and adopted, banks will continue to take unnecessary risks and an inefficient use of resources;

- ***The legislation system is not consistent or internationally compliant:*** Banking policies and legislation reveal many constraints and generate discriminatory treatment between different types of commercial banks and different groups of banks, creating unfair competition. Some regulations interfere directly on bank operations, limiting their independence in doing business. Coupled with this, limited law enforcement in the banking sector has further resulted in problems in the operation of banks.

Bank operations in Viet Nam in general and business services of banks in particular, have been on the path to a more competitive environment and level playing field between different types of credit organizations. Although efforts have been made by local credit institutions in the light of the urgent needs of international integration, the competitiveness of Vietnamese banks remains weak. They are at the embryo stage of banking development, and far behind their counterparts in the region. This is reflected in the following characteristics of the market:

- The operating scale of domestic banks remains small;

- Management capacity and supervision of banks are weak. Project evaluation, supervision, credit supervision and application of banking technology are also limited;

- Advanced banking services and modern banking operations have not been comprehensively developed. Several necessary conditions for the provision of banking services have not yet been fully met;

- There is insufficient network linkages between commercial banks which limits their effectiveness and raises operating costs;

- The infrastructure of banks and economic procedures are developed at a pace, which hinders the development of banking services, thereby reducing competitiveness of the sector. State intervention is ongoing, effectively denying a fair competitive environment between credit organizations;

- Traditional banking services contain many risks in capital sourcing and lending activities, while credit lending quality is low, and overdue debts are overwhelming;

- Advanced banking services, such as asset management, financial consulting, e-banking, monetary exchange, financial intermediaries, and financial information supply and transfer, are still underdeveloped; and

- In comparison with certain types of GATS service provision, Viet Nam's financial and banking services, domestic or cross-border through commercial presence or representatives, are limited. This is clearly shown by the fact that total revenue from the export of financial services only accounts for 3.5% of total revenue of exporting services in 2003.

Recent investments by local commercial banks, in their effort to improve, have raised the quality of customer services and introduced more diverse types of products and services. The next section will look at the impact of liberalization, with a focus on the participation of foreign banks in the local market in years to come and also looks at the views of policy makers and customers on the impact of liberalization.

6 Analysis of Impact of Liberalization

In this section we use data obtained from our survey of 335 individual customers and 60 corporate customers to analyze the impact of bank liberalization. The survey asks bank customers their perception, preferences in using banking services, and reaction to the expansion of choices now open to them as a result of liberalization. The questionnaire was designed with the assumption that banking services will be liberalized to allow the entry of foreign providers on a full National Treatment basis, though foreign service providers would receive no less favorable treatment than their local counterparts. In such a situation, consumers of a service, banking in this case, should have an expanded choice amongst foreign and Vietnamese service providers. Currently, these choices are limited, as foreign banks are still restricted in a number of services, and in modes of supply. What we hope to learn from the survey is how consumers would react to the expanded of choices opened up to them. This reaction will give a hint of the competitiveness of Vietnamese banks as perceived by their customers.

We also look at the way in which banks may react to the changing environment of more foreign competition and higher customer sophistication. Through this analysis we will assess the impact of banking liberalization on the economy as a whole, looking at the impact these changes will have on the banking sector, with analysis of the potential change in market share of different players, based on the reaction from customers and will also look at the impact on the economy an analysis of potential benefits and challenges of banking liberalization for the economy as the whole.

Given the small and non-random sample selection, the results from this survey should be used as a reflection of the perceptions of a sub-set of customers only. Despite this limitation, the survey and analysis aims to send a message of the potential impact of local banking system liberalization in light of its present competitiveness for consideration by bankers and policy makers.

6.1 Impacts on the Banking Sector – Customer Reaction

For credit services, the most important income-generating service, we have analyzed how customer's behavior would impact the bank's balance sheet. We divided customers into corporate and individual, and into those who may move from Vietnamese banks to foreign banks by each type of services, against those who may not move. The services selected for this analysis include loans in Vietnam dong and in foreign currencies, and deposits in dong and in foreign currency.

The numbers in the table below, from our customer survey, show the percentage of customers rather than their share in the bank's portfolio. Looking at this table, we can see that around 45% of customers, corporate or individual, would like to switch their borrowing to foreign banks, rather than borrowing from Vietnamese banks. Whether they can do so is a different story, as not every borrower is qualified in terms of financial statements, profitability, transparency, and other conditions to borrow from foreign banks. The results of our survey indicate that almost half of borrowers would prefer to buy banking services from foreign banks. On the deposit side, more than half of the customers surveyed intended to put their money in foreign banks, if they were able to choose and especially for foreign currencies. The survey found that the loss in deposits would be more than in loans, which means that Vietnamese banks could mobilize less financial resources for their own lending.

Table 12: Change in bank's balance sheet due to customer behavior

Lending Side (Bank's Assets)			Deposit side (Bank's Liabilities)		
All corporate customers					
	Switch	*Don't Switch*		*Switch*	*Don't Switch*
Loans in VND	43%	57%	Deposit in VND	47%	53%
Loans in FX	44%	56%	Deposit in FX	58%	42%
Large corporate customers (>VND 30 bill revenue, 68% of corporate respondents)					
Loans in VND	43%	57%	Deposit in VND	43%	57%
Loans in FX	37%	63%	Deposit in FX	54%	46%
All individual customers					
Loans in VND	47%	53%	Deposit in VND	52%	48%
Loans in FX	41%	59%	Deposit in FX	57%	43%
Large individual customers (VND 2-5 mill income, 48% of individual respondents)					
Loans in VND	53%	47%	Deposit in VND	62%	38%
Loans in FX	44%	56%	Deposit in FX	66%	34%

The survey also took into account firms capital sizes and the share of customers. If we take the largest group of customers, both corporate and individual, we can see how their reaction would affect a bank's balance sheet. For the largest group of corporate customers, which have more than VND 30 billion of revenue and account for 68% of corporate respondents in the sample, the reaction is more conservative compared to the average sample, with a smaller percentage willing to move to foreign banks for loans in foreign exchange and deposits in both currencies. This might reflect the fact that there are transactions costs involved in changing banks for large companies. Larger borrowers may also include SOEs, which still maintain close links with SOCBs due to past credit relationships and favorable treatment. More are willing to switch for deposits than loans, and the share of switching for deposits is higher than for loans, which may be due the limited financial transparency and profitability of some consumers when it comes to borrowing from foreign banks. The share of those that would switch to foreign banks is quite significant for all of the four services and would have a significant impact on Vietnamese banks.

This study was unable to determine the share of a bank assets and deposits lost when customers decided to leave Vietnamese banks in favor of foreign banks. However, the size and share of the largest group of customers can be used as a proxy for analysis purposes. If corporate customers accounted for 65% of Vietnamese bank loans and half decide to leave, the asset side of local banks would be significantly affected. Looking at the behavior of large corporate customers can help us understand the level of impact. This analysis also applies to individual customers, who are expected to account for a growing share in bank's portfolio in the future. The share of individuals who would switch to foreign banks is higher than that of corporate customers, and even more so for deposits from the largest group of individuals, the growing middle-income class.

Our survey of Vietnamese bank's views on bank customer reactions, tells a different story to that above. Many Vietnamese bankers still believe that their depositors would not immediately leave them to go to foreign banks, placing their faith in customers trust and cultural links. However, the survey suggests a different scenario with half of customers willing to leave Vietnamese banks. The survey also asked banks why their customers may have given the reactions they did above. For loans in dong, simple procedures are considered the most important reason for corporate customers switching from Vietnamese to foreign banks, while for individual customers, the most important reason was the professionalism of the banks. These findings are consistent with the earlier findings about customers' preferences when selecting a bank, in which professionalism was highly regarded as important. Interest rate levels and service quality are the next most important reason.

Figure 1: Corporate customer - Loan in VND - Reasons for switching to FB (12 observations)

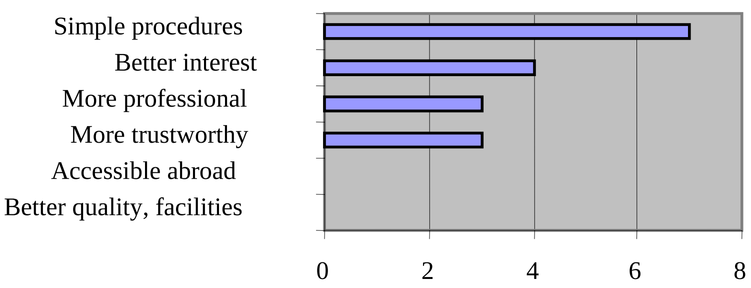
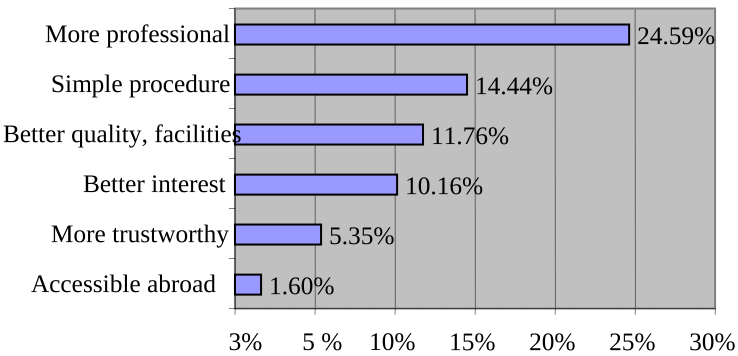


Figure 2: Individual customers - Loan in VND - Reasons for switching to FB, 187 observations



For foreign exchange loans simple procedure was felt to be most important for corporate customers while professionalism was most important for individual customers. The level of interest rates ranked only third for both groups. Trustworthiness did not rank highly for both groups as a reason for change. These findings again confirm that Vietnamese banks have a lot to do in terms of improving their procedures and professionalism, if they want to serve and keep their customers.

Figure 3: Corporate customers - Loans in FX - Reasons for switching to FB (11 observations)

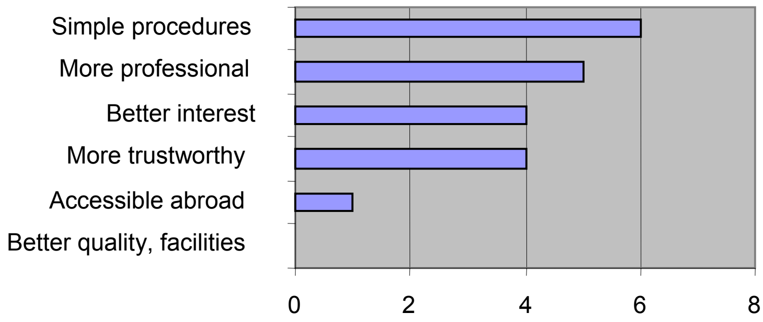
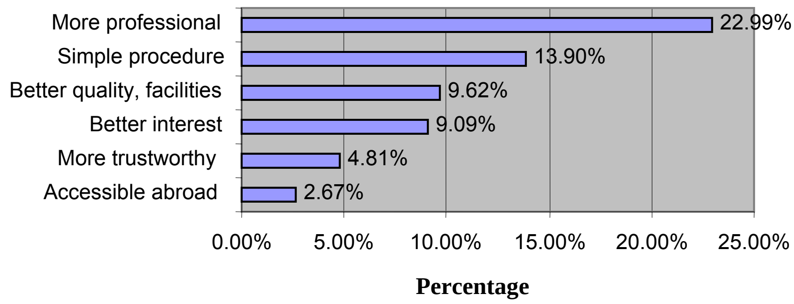


Figure 4: Individual customers - Loan in FX - Reasons for switching to FB



For dong deposits, professionalism was cited by both customer groups as the most important factor for wanting to change to foreign banks while simple procedures was the second most important factor.

Figure 5: Corporate customers – VND deposit Reasons for switching to FB (17 observations)

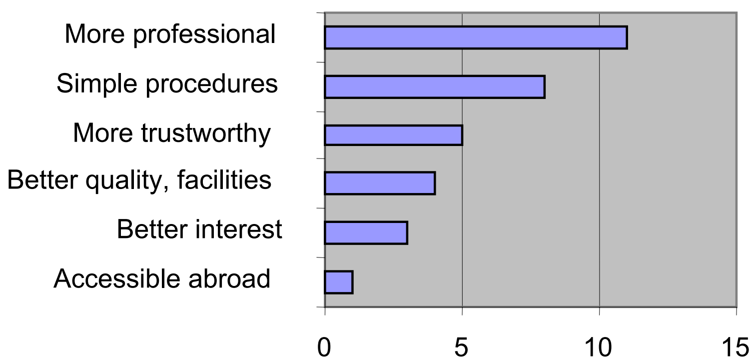
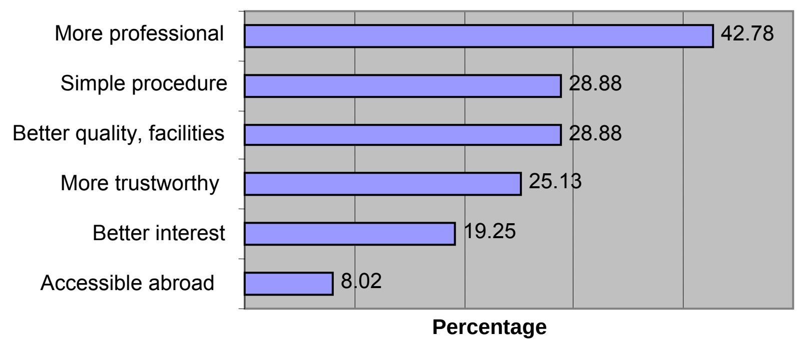


Figure 6: Individual customers - VND deposit - Reasons for switching to FB, 187 observations



For foreign exchange deposits similar reactions were found. It confirms that any bank that can serve and satisfy its customers professionally while offering simple procedures will win a greater market share. The fact that trustworthiness ranks lower in our survey contradicts other findings in the survey where trustworthiness was considered the most important factor of customers when selecting a bank. The survey findings suggests that the level of trust in Vietnamese and foreign banks by customers is not really different and would not constitute a motivation for them to change bank. The real differences between Vietnamese and foreign banks are professionalism and procedural efficiency. This is again an area that needs big improvement in Vietnamese banks.

The lending rates offered by foreign banks may be lower than Vietnamese banks, however when service and other charges are included, the cost of borrowing may not necessarily be lower than Vietnamese banks. Corporate respondents in this survey may not be aware of this issue.

Figure 7: Corporate customers - FX deposit Reasons for switching to FB (23 observations)

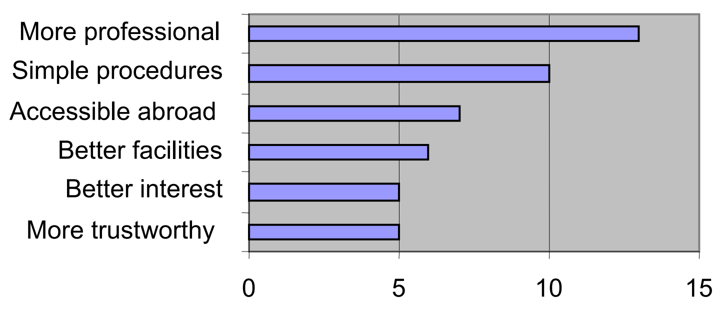
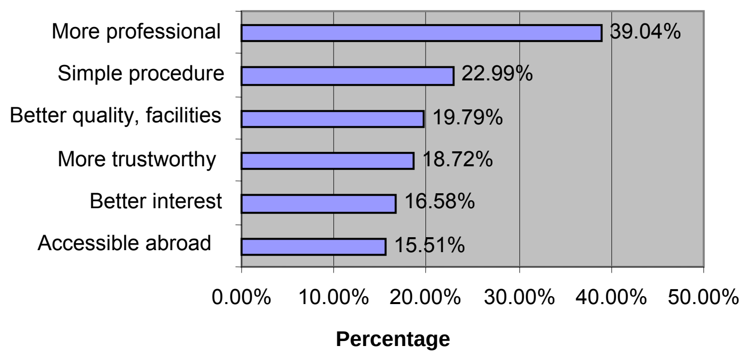


Figure 8: Individual customers - FX deposit - Reasons for switching to FB, 187 observations



The main reasons given in this survey for changing banks place an importance on loan procedures and deposit processing, rather than the bank's ownership or other characteristics. Local banks need to strengthen their competitiveness versus foreign banks in loan procedures and processes.

6.2 Impact on the Economy – Based on the Competitiveness Analysis

In this section we will examine how bank liberalization may have an impact on the economy and the society as a whole. We will analyze with the assumption that liberalization is part of Viet Nam's international integration and commitment implementation process. At the same, regardless of liberalization, the banking sector continues to develop as a result of the overall economic development. Therefore, both banking liberalization and autonomous development is taking place at the same time and interacts with economic development. Banking development, in turn, influences economic development by improving intermediation efficiency and enhancement of customer's benefits.

The impact of bank development and liberalization on economic performance is determined by key stakeholders in this process: the banks, the customers, and the banking sector regulators. Viet Nam will also face a number of challenges externally, as it liberalizes sectors and navigates its own level of international commitments while other countries do the same.

6.2.1 Supply side

On the supply side, banker interviews gave insights into banks' preparations for liberalization and the competition that will come about as a result of the reduction of restrictions on market access. Liberalization means banks have no option than to improve efficiency. This will be good for their customers and the economy as the whole. The fact that advanced local banks are aggressive in expanding their network, launching new services, tailoring their products to fit differentiated groups of customers, etc. indicates a booming banking market with a greater choice for customers. When foreign banks enter the Vietnamese market providing more services and face fewer restrictions, they will bring benefits to customers and create pressure for local banks to improve as well. Not only will the market size will become bigger and be shared by more players, but it will also become more segmented, with more diverse customer's needs, allowing different players to find their own niche areas. Serving SMEs will be one such niche for local small banks, as foreign banks are unlikely to tap into this market.

6.2.2 Demand side

On the demand side, bank customers can choose to use the services at a bank that best suit their needs. Good service that can stimulate demand can result in a higher volume of transactions through the banks, meaning more resources are mobilized and intermediated. Consumer lending is likely to be the fastest growing business. Transactions that were impossible for consumers before, such as acquiring houses and consumer durable goods, or paying for college, are now possible through bank loans. More people could afford to purchase a house or durable goods if they could pay over a longer period of time. This obviously enhances their welfare and economic efficiency. This would also facilitate the formalization of transactions in the economy.

6.2.3 Bank regulators

All of these developments will have implications for bank regulators. In a strictly controlled environment, where both the volume and the type of transaction are limited, regulators have an easier job in supervising the system and ensuring systemic stability. However, when the market is more liberalized, with a growing volume of transactions and complexity, bank regulators have a role to play, which becomes equally complex ensuring the soundness and safety in the system. This challenges bank regulator's capacity to meet the complexity of financial transactions between different parties in the market.

It is even more challenging for the regulator to deal with regulations in today's liberalized environment created in response to international commitments, and in preparation for joining the WTO. Before any rule or regulation is applied, the regulator has to consider how this would affect Viet Nam's trading partners and how they would react or reciprocate. Today, a regulatory measure may affect not only Vietnamese service providers but also those from its trading partners.

As China and Cambodia are already members of WTO, having made substantial commitments in opening up services including banking, Viet Nam's options are limited. Viet Nam does not enjoy much freedom in deciding the level of market access or other commitments.

6.2.4 Social impact

In terms of social impacts of banking development, the literature reviewed and interviews undertaken with banking officials gave quite mixed perspectives.

Literature on international experience provides evidence of positive impact of commercial banking development in rural areas mainly in terms of employment creation and poverty reduction. The experience of India, for example, indicates that the expansion of rural banking can transform production and employment, lead to poverty reduction, and increases in output[40]. In Viet Nam, rural banking has been developed as part of donor funded program, the World Bank funded Rural Finance Project is an example. As part of this project, mobile banking to rural un-served areas is provided by VBA and BIDV; mobile banking cars were first introduced on a large scale in Viet Nam in 2000 and 2001 with 159 mobile banking cars. On average, each mobile banking car visits 62 remote locations per month, adding around 2,000 new savings accounts, worth VND19 billion, and nearly 2,000 new loans, worth VND15 billion; and collecting more than VND10 billion in loan payments a month. These mobile banking operations helped rural households, including ethnic minority households, to maintain

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[40] See Rubin Burgess and Robini Pande, 'Do Rural Banks Matter? Experience from the Indian Social Banking Experiment', 2002.

and improve their livelihoods through increasing their access to banking services[41]. It would be very beneficial if this model was expanded to banks of other ownership forms not just state-owned banks.

Unlike the Indian experience and the mobile banking initiative, Vietnam's Bank for Social Policy (SPB) is quite controversial. Before SPB was created, policy lending was provided by the four SOCBs distorting their commercial business. A positive aspect of SPB's establishment is that it shows the government wishes to separate policy and directed lending from commercial banking. However, the existence of such a subsidized credit arm in parallel with commercial banks is considered by bankers as another distortion of sound financial market practice. According to its mission statement, SPB should provide directed lending, lending at preferential rates using the government budget, and also mobilize deposits with subsidized interest rates for non-commercial purposes. Activities include lending to the poor, job creation activities, student loans, and lending to flood-resistant housing. This raises "doubts concerning the sustainability of its system", the issue of "social policies versus financial principle", and "targeting issues"[42]. SPB's services are currently necessary for social policy purposes, but it should be considered as a transition measure towards more market oriented lending. SPB helps the poor to accumulate productive assets so that they can escape poverty. It also aims at becoming commercially viable for part of its operations at some point in the future, with profits made being used for policy lending, to reduce funding from the government.

6.3 Conclusion

Our survey asked bank customers to put themselves in a position where they can choose bank services according to their preferences. It also asked what customers valued most in using a bank, and how they would react to a changing market. This helps bankers to see how sophisticated customers are, what is most important to them, how best they can serve customers, and where they need to improve in competing for market share. Low level customer sophistication is a message for banks to do more in their promotion and customer education. Of course, with economic development and growing incomes, customers will have more demand for banks and become more sophisticated over time. But education from banks will also play a role in accelerating this process. Information from customers gives the impression that market shares would change in favor of foreign banks, unless Vietnamese banks take action to improve them and to keep their existing customers. Our survey aims to develop a number of policy recommendations and hopefully also helps banks as it provides feedback from customers. It might be useful for individual banks or groups of banks to conduct similar surveys in their market research efforts on a larger scale to find out how satisfied their customers are and what are their preferences.

For the banking regulator and policy maker, the survey is helpful as it reflects Vietnamese banks' competitiveness as viewed from a customer's viewpoint, rather than through statistical numbers or financial statements. Information about customer sophistication gives an idea of the level of market development and appropriate regulatory measures for it. Feedback from customers also shows the challenges faced by Vietnamese banks when greater foreign entry takes place.

Banking development for rural development and poverty reduction has been initiated by the government via both commercial and non-commercial arms. But non-commercial lending for social policy purposes is controversial. Transparency in non-commercial banking institutions is questionable. However, the development of a commercial arm for rural banking and targeting poverty reduction is a promising move which has proven beneficial elsewhere. Therefore, expansion of commercial banking to remote and un-served rural areas is a possibility for policy consideration.

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41 See Viet Nam News website: http://.www.vietnamnews.vnagency.com.vn , April 2, 2004.
42 See Yoichi Izumida, 'Programmed Lending for Social Policies-Challenges for the Viet Nam Bank for Social Policies', Working paper, Department of Agricultural and Resource Economics, University of Tokyo, 2003.

7 Recommendations

Given the current status of Viet Nam's banking system in the context of international integration, especially WTO accession, Viet Nam is urged to work towards the liberalization in a sequential/gradual and closely monitored fashion. In this process, the key players will include the government or its regulatory authority, commercial banks or financial institutions, and banking associations.

The best that the government and the banking regulators should do is to strengthen the prudential regulations, policy transparency, accountability, and credibility for competition. It is also of vital importance for them to take bold steps to improve the corporate governance of SOCBs that belong to the state. The recent decision to equitize SOCBs on a pilot basis has shown a strategic move of the Government aiming to improve the corporate governance of its banks and to create a more market-based competitive business environment. Similar to the banking and financial sector reform of many other developing countries, the government is expected to do more and better in some areas, and less in others. Financial sector reform does not mean leaving everything to the market, or to privatize all at once. Neither does it mean opening up completely to the entry of foreign financial firms or capital flows without a robust regulatory system[43]. There is a vast body of literature that suggests caution with deposit insurance schemes, since this can be a recipe for moral hazard and less supervision by the market. The removal of state ownership should be the main target of the government as it has been proven elsewhere that state ownership triggers less financial sector development, lower productivity, higher interest spread, less private credit, less non-bank financial development, greater concentration of credit, and a tendency towards more crisis and less monitoring[44]. Some of these observations are found in Viet Nam too.

Banking and financial institutions, which are profit oriented private institutions like any other firms, have incentives to make profits in a level marketplace. It is the banks themselves who are in the best position to know what actions are needed to compete in a market where the regulatory environment is rightly set. To improve their competitiveness, Vietnamese banks should better address their weaknesses: inadequate human resource development efforts, inactive in searching for new market opportunities, and development of customer benefit centered promotion strategies. At present, the market is witnessing competition between local banks for new customers through promotional products, bonuses for first time customers, and discount or extra benefits for using partner's products. These promotional activities do not contribute to long term market expansion or competitiveness of banks. In the short run, bank clients can be attracted through promotional events, however, in the long run, customers want credibility and safety for their money.

The banking association, like any other professional association, has a role to play in protecting the interests of its members and to maintain a dialogue with the government, to lobby in international trade talks, to share information among members, and to conduct market research or surveys in the industry. This can be realized if the members understand and support its activities. In many advanced economies, business associations are regarded as powerful bodies with a strong voice in policy advocacy or trade negotiations. This is not the case in Viet Nam, where the association was set up as a quasi-government arm for state-owned banks with less participation of recently established non-state banks. Therefore, it is necessary to re-affirm the role of the association among all banking institutions, especially the strong and most competitive ones.

In line with the findings of the study, the Consultant proposes recommendations in four areas legal and policy framework, development strategy, governance and operation, and other inter-sectoral issues.

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[43] Caprio, G., Rethinking the Government's Role in Finance, 1999.

[44] Caprio, G., Rethinking the Government's Role in Finance, 1999.

7.1 Recommendations for the Legal and Policy Framework

Improvement of the legal framework that governs services within the Vietnamese banking system is the primary issue, and should be undertaken first and as soon as possible in order to create a legal avenue for asserting international practices, while ensuring that services remain suited to Viet Nam. This will essentially facilitate Viet Nam's integration into the world economy, establishing a level-playing field for all credit institutions, and a system of prudential regulations for the safe operation of institutions and the system. The State Bank of Viet Nam should coordinate with the Ministry of Finance and relevant ministries to consider the following recommendations:

Legal framework

The State Bank of Viet Nam should carry out a comprehensive review of current legislation and regulations and their compatibility with obligations/requirements in international agreements. This task should be undertaken as soon as possible to identify bottlenecks, disparities and loopholes.

Based on that, the Government, Ministry of Finance and the State Bank of Viet Nam should immediately revise and amend the current legal framework to ensure that the banking sector is operating in a consistent environment. Such revisions should also take into account the interaction and compliance with other international practices such as regulations on CAR, risk prevention and solving, and required reserves.

The development of new mechanisms, policies and regulations must be in accordance with the implementation roadmap of international commitments in the monetary and banking fields, primarily focusing on implementation of the Viet Nam – US BTA and AFAS, as well as commitments under the WTO. Such a process should also address emerging issues of market development and consumption demand, such as: regulations on operation and safety assurance in e-banking activities, regulations on guidance and management of derivatives, and regulations on modes of banking service provision including cross-border, consumption abroad and presence of natural persons. There also needs to be the promulgation of provisions facilitating the establishment of subsidiaries of foreign banks in Viet Nam as soon as possible.

The State Bank of Viet Nam and the Ministry of Finance (State Securities Commission) should develop mechanisms and policies on transparency and on the disclosure of credit institution information to develop a favorable mechanism for banks to participate in the stock exchange market. On the one hand, the stock market can be a great channel of funding for Vietnamese banks, on the other hand, banks that are listed must perform effectively and transparently.

Awareness of financial service integration and international commitments in banking services should be immediately and widely communicated to, and perceived by bankers and bank staff. An understanding of such impacts currently varies among people working in the banking industry. Therefore, all relevant agencies and stakeholders should be informed in a timely and precise manner, the impacts of liberalization on all Vietnamese banks and credit institutions.

Strengthening local banks:

The State Bank of Viet Nam and the Ministry of Finance should consider the early eliminate of any regulatory documents, norms and procedures that create protection and discrimination between different domestic banking institutions (particularly between SOCB and JSBs). This should be carried out before the application of further liberalization measures towards foreign banking institutions. This will develop the competitiveness of the whole banking sector of Viet Nam against competition from foreign banks.

The State Bank of Viet Nam should further accelerate and institutionalize the application of international standards and practices in banking services and into the governance and operations of the banking system.

Taking into account the weakness and constraints of Viet Nam's banking system the liberalization roadmap should start with regulations on credit services as this is the area where Vietnamese banks are competitive, then extension should be considered for other services.

7.2 Recommendations on a Development Strategy

The State Bank of Viet Nam should have the main responsibility for the formulation and implementation of the bank development strategy together with other banks. The Government, the Ministry of Finance and other relevant ministries/agencies should also play an important role in initiating the direction, coordination and supervision of the strategy.

Revitalization and improvement of financial capacity will help to strengthen the competitiveness of Viet Nam's commercial banks. The Government, Ministry of Finance and State Bank of Viet Nam should coordinate the resolution of SOCBs NPL problems before 2006. At the same time, banks need to increase equity according to the Government's plan so that the capital adequacy ratio increase to more than 6% by 2006 and greater than 8% before 2010.

The restructuring process of SOCBs has been completed in some banks and is continuing in a number of other banks. These banks should quickly complete restructuring before they equitize. Restructuring should not be limited to solving past and current problems but must also develop a system to ensure such problems do not occur in the future. Besides concentrating on financial restructuring, SOCBs should focus on organizational structure, governance mechanisms and human resources as well.

The equitization of SOCBs should be accelerated. The Government's plan to equitize all SOCBs by 2010 is a great challenge, especially as the pilot equitization of Vietcombank and Mekong Housing Bank has taken considerable time. While the State ensures the control of equitized banks by holding at least 51% of shares, attention must be given to the selection of shareholders who are professional bankers/bank management institutions so that they can participate in managing banks after equitization.

Commercial banks should go into strategic long-term partnerships with foreign banks. The deal between Sacombank and ANZ or ACB and Standard Charter Bank is a good reference. Besides the primary goal of increasing capital, foreign banks can facilitate Vietnamese banks successful integration into the world market. Nevertheless, the selection of strategic partners as well as agreements on the level of foreign bank's participation in Vietnamese bank's operation are issues to be carefully considered, taking into account the sovereignty of Vietnamese bank.

Banks of all scales and types should develop comprehensive development strategies and specific action plans. When the State's protection and subsidies are diminishing, banks should be more initiative in increase autonomy and accountability in their operations. Bank's strategies should include decisive steps to ensure that they shift towards operations on wholly market-based principles and strictly commercial objectives.

The State Bank of Viet Nam should coordinate with join-stock commercial banks to develop a clear action plan for consolidation and nurturing of JSBs, particularly JSBs in rural areas, which aim to enhance the financial and managerial capacities of capable banks, and dissolve, merge or sell inefficient banks. This will help to promote the soundness and increased competitiveness of the whole banking system.

To ensure the banking system of Viet Nam operates on a commercial basis, the State Bank of Viet Nam and the Ministry of Finance should coordinate the development of a clear vision and feasible roadmap for the development of the Social Policy Bank and other non-banking credit institutions, including DAF and PCF. In the short term policy lending is still necessary for poverty reduction in some rural areas. The government's intervention in directing credits should be minimized in the long-term.

7.3 Recommendations on Governance and Operations

Recommendations relating to governance and operation should be considered and implemented by all Vietnamese banks. The State Bank of Viet Nam should also play a role in facilitating and supervising implementation.

Branch and services

The institutional capacity of banks should be strengthened through the rationalization of bank's structure. Banks should change their organizational structure from one based on function and geographical location (the branch network) to a structure that accommodates client segments and service groups. This will help banks to improve the quality of services and better serve their respective clients.

For specific banks, the diversification of banking services should be in line with the specialization of services for its client segment, avoiding mass investment. Banks should identify their core banking services and concentrate on improving the quality of such services. Small-scale commercial banks should not immediately try to invest large capital in the provision of modern banking services, such as derivatives, as the demand for such services is still limited and large domestic and foreign banks are more competitive. Small banks should concentrate on strengthening their banking services improving quality, simplifying procedures and improving price competitiveness.

Banks should undertake segmentation of their target market avoiding cover-all approaches. Banks should combine several segmentation methods based on geographical location, types of business and size and demographic criteria including profession and income. Appropriately and effectively segmented banks focus their resources, save marketing costs and improve banking services.

Governance and HRM

Corporate governance in banks should adopt international practices. Attention should be placed on a clear delineation of functions, responsibility and authority between Boards of Executives (management mechanism) and Boards of Directors (operating mechanism). The strategic governance capacity of banking leaders needs urgent improvement.

Together with equitization and share sales to foreign banking institutions, giving the opportunity for the participation of foreign bankers in managing the banks, there should be initiatives for mechanisms to hire foreign banking experts to work in Vietnamese banks. This will help to promote the transfer of international banking experience and know-how to Viet Nam.

Human resource issues should be dealt with urgently. SOCBs should be permitted to apply performance based remuneration schemes and promotion policies to encourage qualified staff. Banks should formulate plans for human resource development and training to 2010. Bank management personnel should be trained in modern banking operations and services, management, supervision and inspection of credit institutions' activities. Bank staff should be trained in risk management, business skills, operation of new banking services and customer services.

Control and evaluation

The State Bank of Viet Nam should carry out an accurate assessment of the quality of banks' balance sheets to help effective banking supervision. In reality, not all banks' balance sheets truly reflect the quality of their performance.

Complete application of international accounting standard should be compulsory for all banks. IAS audits would provide an independent assessment of banks' performance. Recapitalization of banks should be based on IAS calculation to reflect past and future costs of operations and further increase banks' accountability.

Banks should standardize procedures for management and operation. All banking procedures should be integrated into automated systems to improve efficiency and reduce administration costs.

More attention should be given to internal control and risk management activities to ensure safety in bank operations. Banks should be more prudent in participating in the "interest race" to compete for deposits and clients. The application of a credit risk scoring system and bad debt control tools should be implemented.

Banks need to improve transparency as well as reliability and timeliness of performance data, particularly in balance of payments, NPLs and income statements. This information is essential in building trust among clients and investors.

7.4 Other Recommendations

Besides recommendations on the above areas which directly relate to the banking sector in general and banks in particular, the Consultant would also like to propose other recommendations. These recommendations require the coordinated implementation of other industries and sectors outside the banking system. Specifically:

The Government, relevant stakeholders, mass media agencies and banks should encourage a bank-using culture and promote deposit savings and transactions through bank accounts, at the same time limiting cash-using practices.

The Government and relevant ministries and agencies should work together to accelerate the development of input factors and relevant industries such as stock markets, information technology, accounting and auditing practices, and education and training in order to facilitate the development of banking services.

The Government and relevant ministries and agencies such as the Ministry of Justice and Courts at all levels should enhance law enforcement to effectively handle cases of bank fraud, insolvency of borrowers and liquidation of mortgage assets. When the interests of both lenders and borrowers are protected by law they will be encouraged to conduct more business.

The Government, ministries and localities should accelerate state-owned enterprise reforms to support the banking sector in resolving and reducing NPL problems. Without rigorous measures in reforming SOEs and loss-making industries and sectors, Vietnamese banks, particularly SOCBs still continue to suffer NLPs and bad debts. The development of banking services depends largely on the restructuring of SOEs, improving private sector investment and enhancing the governance and transparency of policy making.

Development strategies, trade reform, and liberalization policy should be fed clearly into trade negotiation. Trade negotiations should also be better informed of the competitiveness of different sectors and the needs of the business community. Without a clearly articulated government strategy for development and a thorough analysis of domestic competitiveness, trade negotiations cannot effectively support the country in joining the world trading system.

Finally, key specific measures to address issues in the banking sector analyzed in this report are summarized in the following table, with issues identified, key responsibilities and stakeholders, and recommended actions or rationale.

7.5 Recommendation Matrix

No.	Issues	Main Responsibility/Stakeholders	Actions Recommended, Rationale, and Implications
1. Legal and regulatory framework			
1.1	*Legal review*	SBV, MOF, MOJ, donors	Review regulations directing the implementation of the Law on the State Bank and the Law on Credit Institutions which affect banking services, making sure they are non-discriminatory, enforce prudential regulations, and are consistent with WTO rules and Viet Nam's international commitments.
1.2	*Regulations on new instruments*	SBV, donors	Based on observations of new service development and anticipated services in banking, learn international experience and laws of other advanced economies on how to regulate these instruments or services.
1.3	*Financial transparency and disclosure requirements*	SBV, MOF	Phase-in financial disclosure requirements to reduce information asymmetry problems and to facilitate lending to untraditional customers of banks
1.4	*Legal protection for creditors*	SBV, MOJ	Put in place legal frameworks to protect creditor interests in case of default, de-collateralization of mortgaged assets and land use right.
2. Policy framework			
2.1	*Communication on international commitments and specific impacts on the banking market*	SBV, National Committee of Economic Cooperation, Ministry of Trade	Review and disseminate a list of Viet Nam's international commitments and their impact on every specific services and practices to all commercial banks and banking institutions
2.2	*Key position appointment*	SBV, MOHA	Carefully study conflict of interests in appointing key positions, consider corporate governance structures in multinational banks

No.	Issues	Main Responsibility/Stakeholders	Actions Recommended, Rationale, and Implications
	mechanism		and professional CEO positions.
2.3	*Incentives and remuneration structures*	SBV, MOHA	More performance-based remuneration should be allowed, and a departure from the general government salary scale, plus other reward system a to give the right incentives to employees
2.4	*Clarify the role of quasi-bank institutions, mainstreaming WTO rules and future commitments*	Government, SBV, DAF, VSPB	Non-commercial and preferred credit arrangements should be analyzed with utmost care to avoid potential retaliation or countervailing actions from trading partners on the grounds of domestic support within WTO
2.5	*Enforcement of business transactions through formal banking systems*	Government, SBV	Issue formal rules on bank transactions when possible, to reduce the cash economy, both to expand markets for banking services, and improve financial transparency
2.6	*Non-market elements in SOCBs business decisions*	Government, SBV, SOCBs	Review all the decision making process of SOCBs and draw differences between them and JSBs or fully profit oriented commercial banks, identify any possible change reduce non-market interference in business decisions and measures to address bottlenecks. This can partly be addressed through equitization
2.7	*Promote the development of medium size firms as a driver of growth and a promising market for banks*	Government, MPI, business community, donors	Medium size enterprises have proved to be a very good market for bank lending and service expansion. If the business environment is conducive for numerous SMEs to grow in size and become formalized, it will also provide very good business opportunities for banks.
2.8	*Development of more capital market instruments*	Government, SBV, MOF, business community	The financial sector should be developed in tandem with economic growth and banking liberalization to open more channels and specialization in fund mobilization for

No.	Issues	Main Responsibility/Stakeholders	Actions Recommended, Rationale, and Implications
			intermediations.
2.9	*Rural banking and social objectives*	Government, SBV, MOF, rural SMEs, SOCBs	A separate banking network that serves disadvantaged regions and groups such as People's Credit Funds is desirable in rural areas for poverty reduction and social objectives.
3. Institutional and Organisational Framework			
3.1	*Corporate governance in SOCBs*	Government, SBV	Carefully review the existing governance structure of SOCBs to identify gaps with international best practices, and move closer to international practices.
3.2	*Vision and strategy in SOCB equitization*	Government, SBV	Build a long term vision for SOCBs' role and function in the economy and how best their functions can be performed to achieve the objective through equitization
3.3	*Reward for performance, training, career opportunities to develop and attract human resources*	Commercial bank managers	Even small rewards for good performance are effective in keeping and creating incentives for employees to work for a firm's interest. Career opportunities and satisfactory remuneration is the key to attract qualified employees. All of these measures are especially critical in banking, given the scarcity of human resources and the brain drain problem.
3.4	*Professionalism in customer services and management*	Commercial banks	Our survey of customers indicates that customers value professionalism in service, which is a weakness of Vietnamese banks and should be addressed.
3.5	*Banking modernization*	Government, SBV, commercial banks, donors	Banks need to modernize IT, governance and management styles to be able to compete.
3.6	*Customer education for non-credit service development*	Commercial banks, SBV	Commercial banks themselves need to promote and educate customers and create new demand for their services, rather than passively serve existing demand.

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1 Appendix 1 – Summary of the Development and Reform Process of Viet Nam Banking Sector

1.1 Banking sector prior to 1989

Prior to 1945, monetary, banking and financial systems in Viet Nam were set up and administered by the French colonial authorities, via the Indochina Bank. This bank played the dual role of the central bank and commercial bank for the entire Indochina region (Viet Nam, Laos, and Cambodia).

The Viet Nam National Bank was established in 1951, and was later renamed the State Bank of Viet Nam. In 1976, the Southern based National Bank was amalgamated into the State Bank of Viet Nam, which became the single banking operator for the whole country. The organizational structure of the State Bank consists of its headquarters located in Ha Noi, branches in provinces and cities, and transaction offices in districts across the country.

The development of the Viet Nam banking system prior to 1990 can be divided into the three following periods:

- 1951 – 1954: the National Bank was established and performed a variety of tasks including issuance of bank notes, financial note recollection, state treasury management, savings facilitation and spending centralization;

- 1955 – 1975: the National Bank performed the following tasks: monetary market consolidation, currency stabilization, pricing control, as well as credit management and development; and

- 1975 – 1989: the State Bank of Viet Nam unified currencies throughout the country, issued the currency of the Socialist Republic of Viet Nam taking the old currencies from the South and the North out of circulation. Until the mid 1980s, the State Bank was essentially operating as a budgeting tool, rather than following market principles conducting monetary business operations. Fundamental changes did not begin until the end of the decade, when the banking system gradually began to adopt operations that reflected market principles.

1.2 Reform since 1990 - present

In this period, Viet Nam's banking sector undertook major changes. A milestone was reached in 1990 with the establishment of four State-owned commercial banks (SOCBs). Since then, a two-tier banking system has replaced the singular structure, and the bank's operation has been toward commercial orientation. The State Bank of Viet Nam performs all State management functions and acts as a central bank while second tier groups of commercial banks perform business functions.

Reforms in 1991 to 1992 led to the consolidation and establishment of new joint stock commercial banks (JSBs), joint-venture banks (JVBs), branches and representative offices of foreign banks in Viet Nam. A large number of credit cooperatives were merged and consolidated to form joint stock commercial banks in urban and rural areas. From 1999 till now, joint stock commercial banks have undergone a thorough restructuring process. Several methods have been followed:

- JSBs that were posting losses and weak financial capacity were operating ineffectively or could not increase their capital were dissolved. To date, the State Bank of Viet Nam has revoked the business licences of 17 JCBs. The number of JSBs has reduced from 51 in 1998 to 34 today;

- JSBs operating on a small-scale have been merged or sold to other JSBs to expand their business scope, and enhance financial capacity and competitiveness. However, there has not been a comprehensive or clear strategy to ensure small-scale JSBs are transformed. The State Bank has stipulated that JSBs that cannot meet minimum capital requirements would be forced to merge with financially stronger units;

- Some JSBs on the edge of bankruptcy may receive assistance and be put under special supervision. Most JSBs that have been placed under special supervision have regained an acceptable performance level; and

- Several JSBs have actively raised their chartered capital in order to expand their business scale and improve risk management. To date, most JSBs have met requirements on chartered capital and achieved capital adequacy ratios (CAR) of 8%, and NPLs of less than 4% of total loans.

Other important milestones for Viet Nam's banking sector have been the normalization of relations with the international monetary/financial organizations (IMF, WB and ADB) in 1991, the establishment of the Bank for the Poor in 1995, the liberalization of lending interest rates for Vietnamese dong applied to credit institutions in 2002; and the conversion of the Bank for the Poor to the Social Policy Bank in 2003.

From 2001, significant efforts have been placed on restructuring the four biggest SOCBs, including the Industrial and Commercial Bank (ICB), the Bank for Investment and Development (BIDV), the Bank of Agricultural and Rural Development (VBARD), and the Bank for Foreign Trade of Viet Nam (Vietcombank). Reform was mainly undertaken in the following three areas:

- Re-capitalization on a gradual and conditional basis for SOCBs from social funds in order to improve the bank's financial resources and thus capital adequacy ratio. Existing NPLs can either be written off, or dealt with separately through the asset management company. Future NPLs can be prevented by better risk management and credit analysis. In this sense, the reduction of NPLs and better risk management is a condition for recapitalization of SOCBs;

- Elimination of policy and directed loans; and

- Improvement of standards in accounting and information disclosure by applying International Accounting Standards (IAS), categorizing loans in accordance with international standards, and by implementing prudent, methodical processes, such as required reserves.

1.3 Reform of State-owned Enterprises (SOE)

The reform of the state owned banks is closely associated with the slow speed of SOE reform, which started during the early 1990s. The cosy relationship between banks and enterprises owned by the Government has allowed them to maintain a good business relationship for a long time. Despite the fact that many SOEs are barely solvent, many still enjoy lending discounts of up to 0.4% a month on the general interest rate for dong lending. The banks know that SOE borrowing is backed by a government guarantee and often lend to shaky SOEs ahead of promising private sector firms.

Viet Nam had 12,300 SOEs in 1990 and by March 2005, 2,242 SOEs had been equitized including 753 in 2004, with 4,300 remaining in the hands of central, provincial and municipal governments. The total capital of equitized SOEs amounted to VND17.7trn (US$1.13bn), accounting for 8.2% of the state's capital contribution to these enterprises. Of the SOEs shares equitised, on average, 46.5% are still held by the state, 38.1% have gone to employees and 15.4% have been sold to private investors.

Equitisation has proceeded more slowly than authorities would like, and annual and five-year targets have gone unmet for more than a decade. The strong opposition to equitization is primarily because SOEs have a number of advantages over private firms: they enjoy easier access to credit and to land-use rights (the latter being a highly valued contribution to a joint venture), they are favoured for government contracts and in the award of trade and other licences, and some have access to subsidised loans. Workers and managers, accustomed to the security of working for SOEs, also fear that they could lose their jobs. In addition, several ministries oppose privatisation, as they do not want to give up the enterprises under their control as they are sources of patronage and influence. However, a recent study by the Ministry of Finance of 42 relatively large SOEs found that they generated low returns to equity; such inefficiency is at the heart of the argument for privatisation[45].

The government's emphasis has shifted somewhat in recent years towards fashioning a wider menu of equitisation options. Among the options available, besides dissolutions and mergers, are reorganisations as limited-liability companies (often using a parent-subsidiary corporation structure to allow each SOE unit to operate more independently); reclassifications as public services; leasing; and subcontracting. Under a pilot scheme in place since February 2004, large SOEs involved in key industries such as electricity, telecommunications, banking, insurance and chemicals have begun to undertake equitisation in different forms and over several years. Some SOEs will have all their member companies sold while still acting as a parent company, representing the capital proportion of the state in newly formed subsidiaries. Other SOEs will be entirely equitised, selling all their capital and assets. Still others will be partly equitised. In the pilot scheme's first year, the government focused on restructuring (in preparation for equitisation) the Electronics and Informatics Corp, the Viet Nam Construction and Import-Export Corp, the Construction Import and Export Corp, Vietcombank and the Mekong Housing Development Bank.

[45] www.eiu.com, Vietnam Country Profile 2005

2 Appendix 2 – Comparative matrix of AFAS, BTA commitments and WTO offers

Sectors & Sub-- Sectors	Mode	AFAS Commitments		WTO Offers		VN-US BTA	
		Market Access	National Treatment	Market Access	National Treatment	Market Access	National Treatment
7. FINANCIAL SERVICES B. Banking and other financial services: a. Acceptance of deposits and other repayable funds from the public (CPC 81115 – 81119)	1	1, Unbound	1, Unbound	(1) Unbound	(1) Unbound	(1) Unbound, except for financial information services, B. (i) and (j).	(1) Unbound, except for financial information services, B. (i) and (j).
	2	2, Unbound	2, Unbound	(2) None, except matters concerning exchange control shall be subject to the approval of the State Bank of Viet Nam or shall be subject to limits as specified by the State bank of Viet Nam	(2) None	(2) None	(2) None
	3	3, Unbound to permission of new establishment Unbound, excluding: A foreign and joint-venture bank branch shall be only permitted to perform practice of accepting deposits as specified in the operating license granted by Vietnamese State Bank: A, Accepting time and non-time deposits in Vietnamese Dong from: i, Individuals who are foreign citizens, live and work in Viet Nam ii, Legal entities which are diplomatic missions,	3, Unbound, except what are identified in general conditions for Banking services and horizontal commitments; and: - A foreign and joint venture bank branch is permitted to accept non-time deposits in Vietnamese Dong from Vietnamese individuals and Vietnamese legal entities which do not have credit relationships with the branch, up to the maximum amount of 25% capital provided by the bank in country of origin. - A joint venture bank is permitted to accept non-time deposits in Vietnamese Dong from	3, None, except: (a) Foreign financial service suppliers are only permitted to provide services in Viet Nam through the following legal forms: branch of a foreign bank, joint venture banks between foreign banks and Vietnamese banks, 100% foreign owned financial leasing companies, and joint venture financial leasing companies. Unbound for 100% foreign owned subsidiary bank. (b) For the period ending 5 years from the date of accession, unbound for new licenses for branches of foreign banks;	(3) None, except: (a) For establishment and operation in Viet Nam, branches of foreign banks, joint venture banks, 100% foreign invested financial leasing companies and financial leasing joint ventures must apply for licenses (b) The conditions for the establishment in Viet Nam of the branch of a foreign bank are: - Minimum capital granted by its parent bank of $15 million - parent bank guarantees, in written form, to undertake all responsibilities and commitments of its branch in Viet Nam	(3) None, except the following: a) U.S. financial service suppliers are permitted to provide services in Vietnam through the following legal forms upon entry into force: branches of a U.S. bank, U.S.-Viet Nam joint venture banks, 100% U.S. owned financial leasing companies, and U.S.-Viet Nam joint venture financial leasing companies. b) For the period ending 3 years from the date of entry into force of this Agreement, the only legal form in which other U.S. financial services suppliers (besides	(3) (3) None, except the following: a) In order to establish and operate in Viet Nam, branches of U.S. banks, US bank subsidiaries, and U.S.-Viet Nam joint ventures shall have to apply for a license. b) The conditions for the establishment in Viet Nam of the branch of a bank of the U.S. are: Minimum capital of the branch granted by its parent bank of U.S. $15 million. Parent bank guarantees, in written form, to undertake all responsibilities and commitments of its branch in Viet Nam.

Sectors & Sub-- Sectors	Mo de	AFAS Commitments		WTO Offers		VN-US BTA	
		Market Access	National Treatment	Market Access	National Treatment	Market Access	National Treatment
		international bodies representatives, socio – economic, and foreign charity organizations in Viet Nam iii, Legal entities which are 100% foreign-owned economic institutions in Viet Nam, joint- ventures based in Viet Nam, Vietnamese economic institutions with foreign capital. iv, Legal entities which are Vietnamese economic institutions, except for those mentioned in (c,), with capital loans from foreign and/ or joint venture bank branches. B, Accept time and non-time deposits in Vietnamese Dong, which are transferred from foreign currencies, from individuals and legal entities abroad. C. Accept non-time deposits in Vietnamese Dong from Vietnamese individuals and Vietnamese legal entities who do not have credit relationships with foreign bank and/ or joint venture bank	Vietnamese individuals and Vietnamese legal entities which do not have credit relationships with the joint venture, up to the maximum amount of 25% charter capital . - A foreign and joint-venture bank branch is not permitted to mobilize savings under any form.	(c) Foreign banks may establish joint venture banks in Viet Nam in which the contribution of foreign partners must not exceed 50% legal capital of the joint ventures (d) For the period ending 4 years from the date of accession, the only legal form in which foreign financial service suppliers (besides banks and leasing companies) may provide financial services in Viet Nam is through joint ventures with Vietnamese partners. Thereafter, this limitation shall be abolished. (e) Foreign companies and foreigners are only permitted to acquire equities in a joint- stock bank upon approval of the State Bank of Viet Nam. (f) A branch of a foreign bank will not be permitted to: - Take saving deposits in all forms; - Accept time deposits in Vietnamese Dong from	- Subject to permission of Vietnamese relevant authorities. - Meeting the needs of banking services of the Vietnamese economy. (c) The conditions for the establishment of a joint venture bank are: - Minimum legal capital of $US 10 million - Subject to permission of Vietnamese relevant authorities - Meeting the needs of banking services of the Vietnamese economy (d) The conditions for the establishment of 100% foreign owned leasing and joint venture leasing companies are: - have at least 3 nearest consecutive years of profit making - Minimum legal capital of US$ 5 million - Meet the needs of banking services of the Vietnamese economy. (e) Money transmission: - A foreign bank branch is only permitted to transfer abroad a total amount of less than 30% of the branch's paid –in capital; - A joint venture bank is	banks and leasing companies) may provide financial services in Viet Nam is through joint ventures with Vietnamese partners. Thereafter, this limitation is abolished. c) U.S. banks will be permitted to establish 100% subsidiary banks in Vietnam beginning 9 years after the date of entry into force of this agreement. Until that time, U.S. banks may establish joint-venture banks in Viet Nam in which the equity participation of the U.S. partner shall not be less than 30% but not exceed 49%. d) Viet Nam may limit, on a national treatment basis, equity participation by U.S. banks in privatized Vietnamese state-owned banks to the same level as equity participation by Vietnamese banks. e) During the first 8 years after entry into force of the Agreement, Viet Nam may limit the rights of a U.S. bank	c) The condition for the establishment of a U.S.-Viet Nam joint venture bank or a 100%-owned subsidiary of a U.S. bank is: - Minimum legal capital of US$10 million. d) Financial institutions with 100% U.S. invested capital are not allowed to take an initial mortgage interest in land use rights. Beginning on the date that is 3 years from the date of entry into force of this Agreement, financial institutions with 100% U.S. invested capital shall only be allowed to take an initial mortgage interest in land-use rights held by enterprises with foreign invested capital. In cases of default of such borrowers, financial institutions with 100% U.S. invested capital may acquire and use mortgages or land-use rights for purposes of liquidation. e) The condition for the establishment in Viet Nam of a 100% owned subsidiary of a U.S.

Sectors & Sub-- Sectors	Mode	AFAS Commitments		WTO Offers		VN-US BTA	
		Market Access	National Treatment	Market Access	National Treatment	Market Access	National Treatment
		branches. D. Accept time and non-time deposits in foreign currencies from those mentioned in (A) and (B) E. Accept deposits in Vietnamese and foreign currencies from Vietnamese commercial banks, joint venture banks, and other foreign bank branches in Viet Nam. F. Accept deposits in Vietnamese Dong, which are transferred from foreign currencies, from foreign banks.		Vietnamese citizens and legal entities with which the bank does not have a credit relationship - Accept deposits in Vietnamese Dong of more than 25% of the branch's paid-in capital from Vietnamese citizens and legal entities with which the bank does nor have a credit relationship. - Accept foreign currency deposits from Vietnamese citizens and legal entities with which the bank does not have a credit relationship. (g) a joint venture bank is not permitted to accept foreign currency deposits from Vietnamese citizens and legal entities with which the bank does not have a credit relationship. (h) Branches of foreign banks are not allowed to open other transaction points outside their main offices. Branches of foreign banks are not permitted to open their sub- branches and place automatic teller machine (ATM) at locations other than offices of such banks.	permitted to transfer abroad a total amount of less than 10% of its legal capital. .	branches to accept deposits in dong from Vietnamese persons with which the bank does not have a credit relationship to a ratio of the branch's paid-in capital according to the schedule below. Thereafter, such limitations will be abolished: Year 1: 50% of legal paid-in capital Year 2: 100% of legal paid-in capital Year 3: 250% of legal paid-in capital Year 4: 400% of legal paid-in capital Year 5: 600% of legal paid-in capital Year 6: 700% of legal paid-in capital Year 7: 900% of legal paid in capital Year 8: Full national treatment During the first 10 years after entry into force, Vietnam may limit the rights of a U.S. bank branch to accept deposits in dong from Vietnamese citizens with which the bank does not have a credit relationship to a ratio of the branch's paid-in capital according to the schedule below.	financial leasing company or joint-venture financial leasing company are: Investors must have three consecutive profit making years; Legal capital shall not be less than US$5 million. f) Until the date ending 3 years from the date of entry into force of this Agreement, Vietnam is not obliged to provide full national treatment with regards to access to central bank rediscounting, swaps, and forward facilities.

Sectors & Sub-- Sectors	Mode	AFAS Commitments		WTO Offers		VN-US BTA	
		Market Access	National Treatment	Market Access	National Treatment	Market Access	National Treatment
				(i) Branches of foreign banks and joint ventures are not permitted to underwrite credit and settlement transactions in foreign currencies for Vietnamese citizens and legal entities with which the bank does not have a credit relationship.		Thereafter, such limitations will be abolished: Year 1: 50% of legal paid-in capital Year 2: 100% of legal paid-in capital Year 3: 250% of legal paid-in capital Year 4: 350% of legal paid-in capital Year 5: 500% of legal paid-in capital Year 6: 650% of legal paid-in capital Year 7: 800% of legal paid in capital Year 8: 900% of legal paid in capital Year 9: 1000% of legal paid in capital. Year 10: Full national treatment In no year during the phase-in period shall the combined ratio of Dong deposits to legal paid-in capital of a U.S. bank branch exceed full national treatment. f) Beginning on a date that is 8 years after the date of entry into force of the Agreement, financial institutions with U.S. invested capital are allowed to issue credit cards on a national treatment basis.	

Sectors & Sub-- Sectors	Mode	AFAS Commitments		WTO Offers		VN-US BTA	
		Market Access	National Treatment	Market Access	National Treatment	Market Access	National Treatment
						g) Branches of U.S. banks are not allowed to place automatic teller machines at locations other than offices of such banks until such time as Vietnamese banks are permitted to do so. A branch of a U.S. bank shall not be allowed to open other transaction points. h) Unbound for the management of statutory social security or public retirement plans.	
	4	4, Unbound, except for that identified in general conditions for Banking services and horizontal commitments.	4, Unbound, except for that identified in general conditions for Banking services and horizontal commitments.	(4) Unbound, except as indicated in the horizontal section.	(4) Unbound, except as indicated in the horizontal section	(4) Unbound, except as indicated in Horizontal commitments.	(4) Unbound, except as indicated in Horizontal commitments.
b. Lending of all types, including consumer credit, factoring and financing of commercial transactions (CPC 8113)	1	1, Unbound	1, Unbound	1) Unbound	1) Unbound	(1) similar to VI.B.a	(1) similar to VI.B.a
	2	2, Unbound	2, Unbound	(2) None, except matters concerning exchange control shall be subject to the approval of the State bank of Vietnam or shall be subject to limit as specified by the State bank of Viet Nam.	(2) None	(2) similar to VI.B.a	(2) similar to VI.B.a
	3	3, Unbound to permission of new establishment Unbound, excluding:	3, Unbound, except that identified in general conditions for Banking services and horizontal commitments.	3, None, except: (a) Foreign financial service suppliers are only permitted to	(3) None, except: (a) For the establishment and operation in Viet Nam,	(3) similar to VI.B.a	(3) similar to VI.B.a

Sectors & Sub-- Sectors	Mode	AFAS Commitments		WTO Offers		VN-US BTA	
		Market Access	National Treatment	Market Access	National Treatment	Market Access	National Treatment
		- A foreign and joint-venture bank branch shall be only permitted to perform the practice of lending as specified in operating licenses granted by Vietnamese State Bank: A, Lending in Vietnamese Dong to: i, Individuals who are foreign citizens and live and work in Viet Nam ii, Legal entities which are diplomatic missions, international bodies representatives, socio – economic, and foreign charity organizations in Viet Nam iii, Legal entities which are 100% foreign owned economic institutions in Viet Nam, foreign – Viet Nam joint ventures based in Viet Nam, Vietnamese economic institutions with foreign capital. iv, Vietnamese individuals and Vietnamese institutions B, Lending in foreign currencies to subjects mentioned in (i), (ii), (iii)		provide services in Viet Nam through the following legal forms: branches of a foreign bank, joint venture banks between foreign banks and Vietnamese banks, 100% foreign owned financial leasing companies, and joint venture financial leasing companies. Unbound for 100% foreign owned subsidiary bank. (b) For the period ending 5 years from the date of accession, unbound for new licenses for branches of foreign banks; (c) Foreign banks may establish joint venture banks in Viet Nam in which the contribution of foreign partners must not exceed 50% legal capital of the joint ventures (d) For the period ending 4 years from the date of accession, the only legal form in which foreign financial service suppliers (besides banks and leasing companies) may provide financial services in Viet Nam is through joint	branches of foreign banks, joint venture banks, 100% foreign invested financial leasing companies and financial leasing joint ventures must apply for licenses (b) The conditions for the establishment in Viet Nam of the branch of a foreign bank are: - Minimum capital granted by its parent bank of $15 million - parent bank guarantees, in written form to undertake all responsibilities and commitments of its branch in Viet Nam - Subject to permission of Vietnamese relevant authorities. - Meeting the needs of banking services of the Vietnamese economy. (c) The conditions for the establishment of a joint venture bank are: - Minimum legal capital of $US 10 million - Subject to permission of Vietnamese relevant authorities - Meeting the needs of banking services of the Vietnamese economy		

Sectors & Sub-- Sectors	Mode	AFAS Commitments		WTO Offers		VN-US BTA	
		Market Access	National Treatment	Market Access	National Treatment	Market Access	National Treatment
		in (iv) and legal entities which are Vietnamese economic institutions. C. Lending in Vietnamese and foreign currencies to Vietnamese commercial banks, joint-venture banks and branches of other foreign banks in Viet Nam.		ventures with Vietnamese partners. Thereafter, this limitation shall be abolished. (e) Foreign companies and foreigners may only be permitted to acquire equities of a joint- stock bank upon approval by the State Bank of Viet Nam. (f) Branches of foreign bank are not be permitted to: - Take saving deposits in all forms; - Accept time deposits in Vietnamese Dong from Vietnamese citizens and legal entities with which the bank does not have a credit relationship - Accept deposits in Vietnamese Dong of more than 25% of the branch's paid-in capital from Vietnamese citizens and legal entities with which the bank does nor have a credit relationship. - Accept foreign currency deposits from Vietnamese citizens and legal entities with which the bank does not have a credit relationship.	(d) The conditions for the establishment of 100% foreign owned leasing and joint venture leasing companies are: - having at least 3 nearest consecutive years of profit making - Minimum legal capital of US$ 5 million - Meeting the needs of banking services of the Vietnamese economy. (e) Money transmission: - A branch of foreign bank is only permitted to transfer abroad a total amount of less than 30% of the branch's paid –in capital; - A joint venture bank is permitted to transfer abroad a total amount of less than 10% of its legal capital.		

Sectors & Sub-- Sectors	Mo de	AFAS Commitments		WTO Offers		VN-US BTA	
		Market Access	National Treatment	Market Access	National Treatment	Market Access	National Treatment
				(g) A joint venture bank is not permitted to accept foreign currency deposits from Vietnamese citizens and legal entities with which the bank does not have a credit relationship. (h) Branches of foreign banks are not allowed to open other transaction points outside their main offices. Branches of foreign banks are not permitted to open their sub- branches and place automatic teller machine (ATM) at locations other than offices of such banks. (i) Branches of foreign banks and joint ventures are not permitted to underwrite credit and settlement transactions in foreign currencies with Vietnamese citizens and legal entities with which the bank does not have a credit relationship.			
	4	4, Unbound, except that identified in general conditions for Banking services and horizontal commitments.	4, Unbound, except for that identified in general conditions for Banking services and horizontal commitments.	(4) Unbound, except as indicated in the horizontal section.	(4) Unbound, except as indicated in the horizontal section	(4) similar to VI.B.a	(4) similar to VI.B.a

Sectors & Sub-- Sectors	Mode	AFAS Commitments		WTO Offers		VN-US BTA	
		Market Access	National Treatment	Market Access	National Treatment	Market Access	National Treatment
c. Financial leasing (CPC 8112)	1	1, Unbound	1, Unbound	(1) Unbound	(1) Unbound	(1) similar to VI.B.a	(1) similar to VI.B.a
	2	2, Unbound	2, Unbound	(2) None, except matters concerning exchange control are subject to the approval of the State bank of Viet Nam or are subject to limits as specified by the State bank of Viet Nam.	(2) None	(2) similar to VI.B.a	(2) similar to VI.B.a
	3	3, Unbound to permission of new establishment Unbound, excluding: - Financial leasing companies which operate in Viet Nam will only be permitted to perform the practice of financial leasing, consulting, provide guarantees and other services related to financial leasing as specified in operating licenses granted by Vietnamese State Bank	3, Unbound, except for that identified in general conditions for Banking services and horizontal commitments.	3, None, except: (a) Foreign financial service suppliers are only permitted to provide services in Viet Nam through the following legal forms: branches of a foreign bank, joint venture banks between foreign banks and Vietnamese banks, 100% foreign owned financial leasing companies, and joint venture financial leasing companies. Unbound for 100% foreign owned subsidiary bank. (b) For the period ending 5 years from the date of accession, unbound for new licenses for branches of foreign banks; (c) Foreign banks may establish joint venture	(3) None, except: (a) For the establishment and operation in Viet Nam, branches of foreign banks, joint venture banks, 100% foreign invested financial leasing companies and financial leasing joint ventures must apply for licenses (b) The conditions for the establishment in Viet Nam of the branch of a foreign bank are: - Minimum capital granted by its parent bank of $15 million - Parent bank guarantees, in written form to undertake all responsibilities and commitments of its branch in Viet Nam - Subject to permission of Vietnamese relevant	(3) similar to VI.B.a	(3) similar to VI.B.a

Sectors & Sub-- Sectors	Mo de	AFAS Commitments		WTO Offers		VN-US BTA	
		Market Access	National Treatment	Market Access	National Treatment	Market Access	National Treatment
				banks in Viet Nam in which contributions of foreign partners must not exceed 50% legal capital of the joint ventures (d) For the period ending 4 years from the date of accession, the only legal form in which foreign financial service suppliers (besides banks and leasing companies) may provide financial services in Viet Nam is through joint ventures with Vietnamese partners. Thereafter, this limitation shall be abolished. (e) Foreign companies and foreigners are only permitted to acquire equities of a joint- stock bank upon approval by the State Bank of Viet Nam. (f) Branch of a foreign bank will not be permitted to: - Take saving deposits in all forms; - Accept time deposits in Vietnamese Dong from Vietnamese citizens and legal entities with which the bank does not have	authorities. - Meeting the needs of banking services of the Vietnamese economy. (c) The conditions for the establishment of a joint venture bank are: - Minimum legal capital of $US 10 million - Subject to permission of Vietnamese relevant authorities - Meeting the needs of banking services of the Vietnamese economy (d) The conditions for the establishment of 100% foreign owned leasing and joint venture leasing companies are: - have at least 3 nearest consecutive years of profit making - Minimum legal capital of US$ 5 million - Meet the needs of banking services of the Vietnamese economy. (e) Money transmission: - A branch of foreign bank is only permitted to transfer abroad a total amount of less than 30% of the branch's paid –in capital; - A joint venture bank is permitted to transfer abroad a total amount of		

Sectors & Sub-- Sectors	Mode	AFAS Commitments		WTO Offers		VN-US BTA	
		Market Access	National Treatment	Market Access	National Treatment	Market Access	National Treatment
				a credit relationship - Accept deposits in Vietnamese Dong of more than 25% of the branch's paid-in capital from Vietnamese citizens and legal entities with which the bank does nor have a credit relationship. - Accept foreign currency deposits from Vietnamese citizens and legal entities with which the bank does not have a credit relationship. (g) A joint venture bank is not permitted to accept foreign currency deposits from Vietnamese citizens and legal entities with which the bank does not have a credit relationship. (h) Branches of foreign banks are not allowed to open other transaction points outside their main offices. Branches of foreign banks are not permitted to open their sub- branches and place automatic teller machine (ATM) at locations other than offices of such banks. (i) Branches of foreign banks and joint ventures	less than 10% of its legal capital. .		

Sectors & Sub-- Sectors	Mode	AFAS Commitments		WTO Offers		VN-US BTA	
		Market Access	National Treatment	Market Access	National Treatment	Market Access	National Treatment
				are not permitted to underwrite credit and settlement transactions in foreign currency for Vietnamese citizens and legal entities with which the bank does not have a credit relationship.			
	4	4, Unbound, except for that identified in general conditions for Banking services and horizontal commitments.	4, Unbound, except for that identified in general conditions for Banking services and horizontal commitments.	(4) Unbound, except as indicated in the horizontal section.	(4) Unbound, except as indicated in the horizontal section	(4) similar to VI.B.a	(4) similar to VI.B.a
d. All payment and money transmission services, including credit, charge and debit cards, travellers' cheques and bankers drafts (including export – import payment) (CPC 81339)		1, Unbound	1, Unbound	(1) Unbound	(1) Unbound	(1) similar to VI.B.a	(1) similar to VI.B.a
	2	2, Unbound	2,Unbound	(2) None, except exchange control shall be subject to the approval of the State Bank of Viet Nam or subject to limits as specified by the State Bank of Vietnam.	(2) None	(2) similar to VI.B.a	(2) similar to VI.B.a
e. Guarantees and commitments (CPC 81199**)	3	3, Unbound to permission of new establishment	3, Unbound, except for that identified in general conditions for Banking services and horizontal	3, None, except: (a) Foreign financial service suppliers are	(3) None, except: (a) For establishment and operation in Viet	(3) similar to VI.B.a	(3) similar to VI.B.a

Sectors & Sub-- Sectors	Mode	AFAS Commitments		WTO Offers		VN-US BTA	
		Market Access	National Treatment	Market Access	National Treatment	Market Access	National Treatment
h. Money broking i. Asset management, such as cash or portfolio management, all forms of collective investment management, pension fund management, custodial depositary and trust services j. Settlement and clearing services for financial assets, including securities, derivative products, and other negotiable instruments k. Advisory, intermediation and other auxiliary financial services on all activities listed above, including credit reference and analysis, investment and portfolio research and advice, advice on acquisitions and on corporate restructuring and strategy (CPC 81339** + CPC 81319)		Unbound, excluding: - Foreign and joint-venture bank branch are only permitted to perform payment and money transmission as specified in operating licenses granted by Vietnamese State Bank: A, Practicing payment in Vietnamese Dong to: i, Individuals who are foreign citizens and live and work in Viet Nam ii, Legal entities which are diplomatic missions , international bodies representatives, socio – economic, and foreign charity organizations in Viet Nam iii, Legal entities which are 100% foreign owned economic institutions in Viet Nam, foreign – Viet Nam joint ventures based in Viet Nam, Vietnamese economic institutions with foreign capital. iv, Legal entities who are Vietnamese economic institutions, except for those mentioned in (iii), with	commitments.	only permitted to provide services in Viet Nam through the following legal forms: branch of a foreign bank, joint venture banks between foreign banks and Vietnamese banks, 100% foreign owned financial leasing companies, and joint venture financial leasing companies. Unbound for 100% foreign owned subsidiary bank. (b) For the period ending 5 years from the date of accession, unbound for new licenses for branches of foreign banks; (c) Foreign banks may establish joint venture banks in Viet Nam in which the contribution of foreign partners must not exceed 50% legal capital of the joint ventures (d) For the period ending 4 years from the date of accession, the only legal form in which foreign financial service suppliers (besides banks and leasing companies) may provide financial services in Viet	Nam, branches of foreign banks, joint venture banks, 100% foreign invested financial leasing companies and financial leasing joint ventures must apply for licenses (b) The conditions for the establishment in Viet Nam of the branch of a foreign bank are: - Minimum capital granted by its parent bank of $15 million - parent bank guarantees, in written form to undertake all responsibilities and commitments of its branch in Viet Nam - Subject to permission of Vietnamese relevant authorities. - Meeting the needs of banking services of the Vietnamese economy. (c) The conditions for the establishment of a joint venture bank are: - Minimum legal capital of $US 10 million - Subject to permission of Vietnamese relevant authorities - Meeting the needs of banking services of the Vietnamese economy		

Sectors & Sub-- Sectors	Mo de	AFAS Commitments		WTO Offers		VN-US BTA	
		Market Access	National Treatment	Market Access	National Treatment	Market Access	National Treatment
		lent capital from foreign bank and/or joint-venture bank branch. v, Individuals and legal entities abroad vi, Vietnamese individuals and Vietnamese legal entities who do not have credit relationships with foreign banks and/ or joint venture banks which operate in Viet Nam. B, Practicing payment in foreign currencies to subjects mentioned in (i), (ii), (iii), (iv), (v) in (A) C. Transmission of foreign currency from abroad into Viet Nam and vice versa in accordance with Viet Nam's laws.		Nam is through joint ventures with Vietnamese partners. Thereafter, this limitation shall be abolished. (e) Foreign companies and foreigners may only be permitted to acquire equities of a joint- stock bank upon approval by the State Bank of Viet Nam. (f) Branch of a foreign bank will not be permitted to: - Take saving deposits in all forms; - Accept time deposits in Vietnamese Dong from Vietnamese citizens and legal entities with which the bank does not have a credit relationship - Accept deposits in Vietnamese Dong of more than 25% of the branch's paid-in capital from Vietnamese citizens and legal entities with which the bank does nor have a credit relationship. - Accept foreign currency deposits from Vietnamese citizens and legal entities with which the bank does not have a credit relationship.	(d) The conditions for the establishment of 100% foreign owned leasing and joint venture leasing companies are: - having at least 3 nearest consecutive years of profit making - Minimum legal capital of US$ 5 million - Meeting the needs of banking services of the Vietnamese economy. (e) Money transmission: - A branch of foreign bank is only permitted to transfer abroad a total amount of less than 30% of the branch's paid –in capital; - A joint venture bank is permitted to transfer abroad a total amount of less than 10% of its legal capital. .		

Sectors & Sub-- Sectors	Mo de	AFAS Commitments		WTO Offers		VN-US BTA	
		Market Access	National Treatment	Market Access	National Treatment	Market Access	National Treatment
				(g) A joint venture bank is not permitted to accept foreign currency deposits from Vietnamese citizens and legal entities with which the bank does not have a credit relationship. (h) Branches of foreign banks are not allowed to open other transaction points outside their main offices. Branches of foreign banks are not permitted to open their sub- branches and place automatic teller machine (ATM) at locations other than offices of such banks. (i) Branches of foreign banks and joint venture are not permitted to underwrite credit and settlement transactions in foreign currencies for Vietnamese citizens and legal entities with which the bank does not have a credit relationship.			
	4	4, Unbound, except for that identified in general conditions for Banking services and horizontal commitments.	4, Unbound, except for that identified in general conditions for Banking services and horizontal commitments.	(4) Unbound, except as indicated in the horizontal section.	(4) Unbound, except as indicated in the horizontal section	(4) similar to VI.B.a	(4) similar to VI.B.a

Sectors & Sub-- Sectors	Mode	AFAS Commitments		WTO Offers		VN-US BTA	
		Market Access	National Treatment	Market Access	National Treatment	Market Access	National Treatment
	1			(1) Unbound	(1) Unbound	(1) similar to VI.B.a	(1) similar to VI.B.a
	2			(2) None, except matters concerning exchange controls will be subject to the approval of the State bank of Viet Nam or will be subject to limits as specified by the State bank of Viet Nam.	(2) None	(2) similar to VI.B.a	(2) similar to VI.B.a
	3			3, None, except: (a) Foreign financial service suppliers are only permitted to provide services in Viet Nam through the following legal forms: branches of a foreign bank, joint venture banks between foreign banks and Vietnamese banks, 100% foreign owned financial leasing companies, and joint venture financial leasing companies. Unbound for 100% foreign owned subsidiary bank. (b) For the period ending 5 years from the date of accession, unbound for new licenses for branches of foreign banks; (c) Foreign banks may establish joint venture	(3) None, except: (a) For the establishment and operation in Viet Nam, branches of foreign banks, joint venture banks, 100% foreign invested financial leasing companies and financial leasing joint ventures must apply for licenses (b) The conditions for the establishment in Viet Nam of the branch of a foreign bank are: - Minimum capital granted by its parent bank of $15 million - parent bank guarantees, in written form to undertake all responsibilities and commitments of its branch in Viet Nam - Subject to permission of Vietnamese relevant	(3) similar to VI.B.a	(3) similar to VI.B.a

Sectors & Sub-- Sectors	Mode	AFAS Commitments		WTO Offers		VN-US BTA	
		Market Access	National Treatment	Market Access	National Treatment	Market Access	National Treatment
				banks in Viet Nam in which contribution of foreign partners must not exceed 50% legal capital of the joint ventures (d) For the period ending 4 years from the date of accession, the only legal form in which foreign financial service suppliers (besides banks and leasing companies) may provide financial services in Viet Nam is through joint ventures with Vietnamese partners. Thereafter, this limitation shall be abolished. (e) Foreign companies and foreigners are only permitted to acquire equity in joint- stock banks upon approval by the State Bank of Viet Nam. (f) Branches of a foreign bank will not be permitted to: - Take saving deposits in all forms; - Accept time deposits in Vietnamese Dong from Vietnamese citizens and legal entities with which the bank does not have	authorities. - Meets the needs of banking services of the Vietnamese economy. (c) The conditions for the establishment of a joint venture bank are: - Minimum legal capital of $US 10 million - Subject to permission of Vietnamese relevant authorities - Meets the needs of banking services of the Vietnamese economy (d) The conditions for the establishment of 100% foreign owned leasing and joint venture leasing companies are: - have at least 3 consecutive years of profit making - Minimum legal capital of US$ 5 million - Meet the needs of banking services of the Vietnamese economy. (e) Money transmission: - A branch of a foreign bank is only permitted to transfer abroad a total amount of less than 30% of the branch's paid –in capital; - A joint venture bank is permitted to transfer abroad a total amount of		

Sectors & Sub-- Sectors	Mode	AFAS Commitments		WTO Offers		VN-US BTA	
		Market Access	National Treatment	Market Access	National Treatment	Market Access	National Treatment
				a credit relationship - Accept deposits in Vietnamese Dong of more than 25% of the branch's paid-in capital from Vietnamese citizens and legal entities with which the bank does nor have a credit relationship. - Accept foreign currency deposits from Vietnamese citizens and legal entities with which the bank does not have a credit relationship. (g) a joint venture bank is not permitted to accept foreign currency deposits from Vietnamese citizens and legal entities with which the bank does not have a credit relationship. (h) Branches of foreign banks are not allowed to open other transaction points outside their main offices. Branches of foreign banks are not permitted to open sub-branches and place automatic teller machines (ATM) at locations other than offices of such banks. (i) Branches of foreign banks and joint ventures	less than 10% of its legal capital.		

Sectors & Sub-- Sectors	Mode	AFAS Commitments		WTO Offers		VN-US BTA	
		Market Access	National Treatment	Market Access	National Treatment	Market Access	National Treatment
				are not permitted to underwrite credit and settlement transactions in foreign currencies for Vietnamese citizens and legal entities with which the bank does not have a credit relationship.			
	4			(4) Unbound, except as indicated in the horizontal section.	(4) Unbound, except as indicated in the horizontal section	(4) similar to VI.B.a	(4) similar to VI.B.a
f. Trading for own account or on the account of customers, whether on an exchange, in an over-the- counter market or - money market instruments (cheques, bills, certificate of deposit, etc) (CPC 81339**) - foreign exchange (CPC 81333) - derivative products including futures and options (CPC 81339**) - exchange rate and interest rate instruments including products such as swaps, forward rate agreements, etc (CPC 81339**) - transferable securities (CPC 81321**) - other negotiable instruments and	1			(1) Unbound	(1) Unbound	(1) Unbound	(1) Unbound
	2			(2) None	(2) None	(2) None	(2) None
	3			(3) Unbound, except for non-bank foreign security service suppliers are only permitted to establish representative offices in Viet Nam	(3) Unbound	(3) A non-bank U.S. securities service supplier is permitted to establish only representative offices in Viet Nam.	(3) None
	4			(4) Unbound, except as indicated in the horizontal section.	(4) Unbound, except as indicated in the horizontal section.	(4) Unbound except as provided in Horizontal commitments.	(4) Unbound except as provided in Horizontal commitments.

Sectors & Sub-- Sectors	Mode	AFAS Commitments		WTO Offers		VN-US BTA	
		Market Access	National Treatment	Market Access	National Treatment	Market Access	National Treatment
financial assets including bullion (CPC 81339**) g..Participation in issues of all kinds of securities including under- writing and placement as agent (whether publicly or privately) and provision of services related to such issues (CPC 8132)							