

I N S I D E T H E M I N D S

Navigating Banking and Finance Law in the Asia-Pacific

*Leading Lawyers on Responding to the Latest
Laws, Trends, and Client Needs*



ASPATORE

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Counseling Clients in
a Volatile Vietnamese
Economic Environment

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Introduction

My practice focuses on banking and finance clients from commercial banks, finance companies, insurance companies, investment funds, and private equity firms. Commercial banks and finance companies form the majority of my firm's banking and finance client base. This reflects an evolution in our client base. Previously, lawyers in the firm advised domestic commercial banks that were lenders in project financing transactions and syndicated loan transactions. Our client base comprised State-owned banks, which are the largest commercial banks in Vietnam. We have advised four of the biggest State-owned banks on their significant lending transactions. With the increased participation of foreign banks in the Vietnamese market, we have also gained new clients: foreign bank branches, foreign-owned banks operating in Vietnam, and overseas lenders in lending transactions with Vietnamese companies.

With the increase of foreign direct investment and project finance transactions in Vietnam, as well as the increase in offshore fundraising by Vietnamese companies, my firm has developed an expertise in cross-border transactions and built a large client base comprising international commercial and investment banks and financial institutions that participate in financing transactions related to projects in Vietnam, sponsors in infrastructure projects, and overseas participants in capital market transactions. The firm's banking and finance practice covers a full spectrum of corporate finance, project finance, asset finance, capital markets, and regulatory advice.

In this chapter, I will discuss the key trends in the Vietnam banking and finance sector, the impacts of the global economic crisis, the legal and regulatory challenges faced by market players in the current market conditions, and the best strategies to deal with these challenges.

Mergers, Acquisitions, and Consolidation in Vietnam Banking and Finance

The most important trend in Vietnam banking and finance is mergers and acquisitions (M&A) and consolidation in the banking and finance sector. Vietnam is seen as a promising market, especially for commercial banks.

Current banking services have only reached a relatively small proportion of the population. Foreign banks and finance companies use M&A as a route to enter the Vietnamese market or expand existing operations. Bank consolidation may become a reality because commercial banks (except branches of foreign banks) are under pressure to increase charter capital to meet the minimum statutory charter capital requirements. As at the end of 2010, more than half of joint stock (shareholding) commercial banks have not been able to meet the prescribed charter capital requirement of VND 3,000 billion. In addition, the regulators have also indicated their policies to further increase minimum charter capital requirements applicable to credit institutions. Small commercial banks must raise additional charter capital despite the economic downturn that is expected to continue beyond 2011.

M&A in the banking and finance sector has also been driven by the need to restructure operations during and after the economic crisis, and the fact that many large economic groups in Vietnam wish to participate in the banking and finance sector. With Vietnam's inclusion in the World Trade Organization, the Vietnamese banking and finance market has been gradually opened up to foreign participants, and foreign banks now have a more level playing field with local banks. Foreign banks are seen as having advantages in technology, capital, management capacity, and development strategies, but they still need to adjust their commercial operations to adapt to the market environment in Vietnam. For example, they must first understand local customers' mentality and culture factors in order to shape their strategies and tailor their services offered in Vietnam. Foreign banks tend to focus on the best segment of customers, being the group with high and middle income in big cities and provinces with high economic potential. Some banks have focused on building their brand awareness, which plays up the prestige factor and the convenience of their international network, and have conducted marketing through personalized financial services with the hope that the satisfactory existing customers will refer their services to other valuable potential customers. Local banks are therefore facing fiercer competition from foreign banks, and they must focus on rethinking their strategies and solidifying their client base in order to compete. The benefits of having foreign strategic shareholders and economies of scale will also drive the need for cooperation and consolidation among banks.

Expansion into the Real Estate and Securities Sectors

In recent years, especially during the period of 2006 to 2007, many banks and finance companies expanded their operations into the real estate and securities sectors. These expansions may define the behavior of and shape the future of the banking and finance sector. They are seen as responses to the macro policies in the Vietnamese banking and finance sector. For example, the trend of M&A and consolidation of banks may develop because of the regulatory policy aiming at shoring up bank capital and prudential management of credit institutions. These trends carry implicit risks, especially within the banking and finance sector. Overly aggressive diversification of business exposes banks and finance companies to more risk, for example, if the banks and finance companies are overexposed to the real estate sector, which endured the bubble in 2007 and 2008. As banks are required to increase their capital and grow bigger in size at the same time that the growth is not supported by commercial growth, the risk of bank failure is more serious.

Difficulty in Accessing Foreign Capital

According to the Ministry of Planning and Investment of Vietnam, the total amount of registered foreign direct investment in the first four months of 2011 is about US\$4 billion, which is about 52 percent of the total foreign direct investment in the same period in 2010.¹ The investment conditions have become more challenging to foreign investors due to many factors, including effects of the global economic downturn, volatile macroeconomic conditions in Vietnam, a high inflation rate, and the consistent depreciation of the Vietnamese dong against the US dollar. Beginning in the last quarter of 2008, the Vietnamese dong faced significant downward pressure against the US dollar due to a trade deficit in Vietnam. In response, the State Bank of Vietnam rationed the supply of US dollars into the banking system and lowered exchange rates to ease downward pressures. In November 2009, the Vietnamese government depreciated the Vietnamese dong by approximately 5.4 percent against the US dollar, with the State Bank of Vietnam setting an inter-bank exchange rate of VND17,961 per US dollar.

¹ Ministry of Planning and Investment, *FDI falls almost 50 percent in four months* (April 27, 2011), www.mpi.gov.vn/portal/page/portal/mpi_en/32343?pers_id=417323&item_id=18975892&p_details=1

The State Bank of Vietnam also narrowed the trading band of the Vietnamese dong against the US dollar from 5 to 3 percent. On February 11, 2011, the State Bank of Vietnam set an inter-bank exchange rate of VND20,693 to US\$1.00 and further narrowed the trading band of the Vietnamese dong against the US dollar from 3 to 1 percent. This devaluation is one of the largest since 1993 and is the fourth devaluation in fifteen months. I anticipate that Vietnamese companies, including companies operating in the banking and finance sector, will have greater difficulty in accessing private equity capital because foreign private equity investors may have been affected by the recent global economic downturn, and those who are active demand higher return rates and stricter investment criteria.

The development of the above trends of M&A, consolidation, business diversification, and reduction in foreign investment in the Vietnam banking and finance sector will depend on the Vietnamese government's ability to stabilize the macro economy, restore trade imbalances, and release pressure on the local currency. I expect that the pressure on banks for consolidation will continue. While foreign investment may decline due to the economic downturn, there will still be new investors, including private equity and investment funds, coming into Vietnam because valuation has dropped and the market is still seen as a strong medium- to long-term play.

The Impact on Legal Practitioners

These trends will potentially result in complex banking, finance, and M&A transactions that will involve not only banking and finance issues but also potential cross-disciplinary legal issues in areas such as securities, competition, litigation, bankruptcy, and real estate. As such, lawyers must build up technical capability in the banking and finance area as well as across disciplines. Lawyers must also stay in tune with changes in the economic environment, keep abreast with recent and proposed changes in laws and regulations, and monitor the policies of regulators.

Many legal issues arise during the M&A deal process, and lawyers tend to take a more conservative approach in interpreting regulations. Opening a dialogue with regulators to seek clarifications and policy guidance on issues that are not clear-cut, or for which there is no precedent, is important.

Lawyers should also seek to participate in the drafting of, and consultation relating to, new laws and regulations in areas in which there is lack of clarity or little precedent, such as securities regulations, offshore investments by Vietnamese companies, and bank M&A activity. I anticipate that regulators will become more robust in their supervision, and that there will be more changes in regulations in the banking and finance sector.

Recent Regulatory Initiatives

Regulations seek to tighten credit policy and curb credit growth, especially in the real estate and securities sectors. In 2010, the State Bank of Vietnam issued Circular 13/2010/TT-NHNN (as amended) on prudential regulations that are applicable to credit institutions that include banks, finance companies, and finance leasing companies. Circular 13 is the most comprehensive prudential regulation that has been issued to date. It covers requirements for capital adequacy, credit exposure limits, liquidity risk management, and investment in subsidiary and non-subsidiary companies. Circular 13 closely follows the spirit and content of Basel I, which is the round of deliberations by central bankers from around the world resulting in a set of minimal capital requirements for banks published in 1988 by the Basel Committee in Basel, Switzerland. This is also known as the 1988 Basel Accord, which was enforced by law in the Group of Ten countries in 1992. Basel I has since been viewed as outdated and was replaced by Basel II in 2004. The framework prescribed by Circular 13 closely follows Basel I with focus on credit risk.

Under Circular 13, credit institutions (excluding foreign banks' branches) are now subject to higher minimum capital adequacy ratio of 9 percent compared to the previous requirement of 8 percent. Credit institutions are also required to maintain a capital adequacy ratio of at least 9 percent on both on an individual and consolidated basis. This is seen as a progressive regulatory response to the aggressive expansion of Vietnamese commercial banks into diversified financial groups in recent years. Circular 13 also aims to curb the funding flows into the real estate and securities sectors, as well as toughen the rules on investment by credit institutions to restrict such institutions from diversifying their investment away from the core business. The law does this by imposing a ceiling on total investments in subsidiaries (no higher than 25 percent of a credit institution's owner equity), and on

total investments in subsidiaries and non-subsidiaries of 40 percent of a credit institution's owner equity. In addition, a credit institution cannot own more than 11 percent in a non-subsidiary entity. Loans to real estate business attract the highest credit risk weight factor of 250 percent.

Role of Regulatory Agencies in Vietnam

The State Bank of Vietnam has the overall supervision in the banking and finance area, and it is responsible for monetary policies, banking, and foreign exchange activities. It acts as a central bank in issuing money and providing monetary services for the government. Apart from the State Bank of Vietnam, other State agencies involved in regulating the banking and finance sector include the State Securities Commission of Vietnam and the Ministry of Finance. In communicating with officials in these agencies, clients or lawyers need to prepare by conducting research on possible precedents, focusing the officials' attention on the issues at hand, and developing possible solutions to save time and effort of both sides.

The Impact of the Global Economic Crisis on Vietnamese Banking and Finance

The most visible effect is the reduction in foreign investment flow into Vietnam. Foreign investors have cut down on investment in emerging markets in general, because most of the key investor countries have suffered from the economic crisis. The volatile economic conditions in Vietnam have heightened investors' concern about risks of Vietnam investment, which in turn will seriously affect the ability of Vietnamese businesses to obtain foreign investment.

Commercial banks and finance companies have faced obstacles as a direct and indirect result of the global economic downturn. Share prices of listed banks and finance companies have heavily declined compared to their peaks during the stock market bubble in 2007. The economic recession, coupled with less-than-effective macroeconomic policies in Vietnam, has led to serious challenges to Vietnamese businesses. This may lead to a higher level of nonperforming loans and affect repayment of foreign loans. The most notable case was the default of the State-owned shipbuilder Vinashin

Business Group on the US\$600 million loan from international lenders in December 2010.

The Impact of the Downturn on Clients

The macroeconomic situation affects banking and finance clients in terms of both bottom-line profit and supply of capital. It has become increasingly difficult to mobilize capital, especially for medium-size enterprises. The capital flow into the stock market has dwindled in recent months, and credit institutions have to tighten credit growth and be more conservative in lending. As such, companies have to diversify fundraising channels, for example, shifting to corporate bonds and private equity investments rather than relying on mobilizing funds through stock markets.

Ascension of Corporate Bonds for Raising Capital

There are a variety of capital products available in Vietnam, including bank loans, bonds, mezzanine financing, private equity, public equities, project finance, foreign direct investment, government funding, and overseas development assistance. However, capital markets continue to be under pressure as the macroeconomic situation puts pressure on stock prices and high interest rates become a burden for corporate borrowers. It has been difficult to raise capital via stock exchanges. Listed companies tend to seek convertible bonds as a way to attract capital while providing investors with downside protection and equity upside. I have seen a shift in the capital market practice as my firm's clients—large, listed companies—move toward raising funds by issuing corporate bonds both onshore and, increasingly, offshore. The corporate bond market is active as banks' appetites for bonds increases as an alternative channel to lend.

Guiding Clients Through Regulatory Gray Areas

Client needs have become more complex compared to previous bank lending transactions. The transactions are getting more structurally sophisticated. Current banking and finance laws and regulations may be inadequate to address issues arising from these transactions. A banking and finance transaction may be subject to various laws and regulations, such as the Law on Enterprises, the Investment Law, the Securities Law, the

Competition Law, the Civil Law, and the Law on Credit Institutions, as well as implementation regulations issued by various competent authorities. However, the regulatory framework lacks clarity and contains many contradictory regulations that are difficult to reconcile. Due to the lack of specific regulations in areas such as bank mergers, and the fact that many relevant laws and regulations are still in the infancy stage, there are gray areas that necessitate consultations with relevant regulators. As a result, client needs can set precedents. Therefore, lawyers need to have not only a firm understanding of the regulations and the issues arising from their application in practice, but they must also be able to assist clients in seeking clarification and guidance from regulators.

While the majority of banking and finance deals in the past were inbound investment and domestic transactions, more recently I have seen the first offshore investments by and acquisitions of foreign-owned businesses by Vietnamese companies. I anticipate that offshore investments will become increasingly popular as Vietnamese companies seek to diversify their business and hedge their risks. This commercial reality demands the need for lawyers with international experience and capability to work with international advisers and manage cross-border transactions.

Accordingly, clients now have higher demands in terms of quality of legal services. Banking and finance transactions involve tremendous pressure in terms of timing, and clients demand faster responses, commercial advice, and immediate action from legal advisers. International clients are also more aware of the market conditions and legal framework in Vietnam. My firm's domestic clients are more sophisticated and more aware of the commercial practice in overseas jurisdictions. The fact that clients are savvier about cross-border transactions puts more pressure on local lawyers to perform.

Best Practices for Developing Client Investment Strategies

As in every investment, foreign clients need to conduct their own due diligence to gain a good understanding of the market. In reality, the Vietnam market may not follow the trends or principles applied in more developed markets. Investors must be mindful of the challenges presented by the complex but ineffective legal and administration framework in the banking and finance areas. Different governmental regulators are involved

in the banking and finance industry, but cooperation among them is less than effective. Therefore, banking and finance transactions may be subject to various laws and regulations that contain contradictory provisions and can cause confusion or further complicate the transaction.

Given the current environment, it is useful to engage local lawyers to facilitate an understanding of the Vietnamese legal framework and the laws and regulations relevant to clients' investments. Investors will benefit from close contacts with good lawyers who have a firm understanding of the market, a good relationship with regulators, and solid experience in the banking and finance areas, especially in cross-border transactions or domestic transactions involving foreign parties. These lawyers can help clients prepare for an entry strategy and during clients' involvement in the market.

Obstacles and Challenges of Vietnamese Banking and Finance Matters

There is pressure on banks, especially small commercial banks, to increase capital to meet the minimum charter requirements. Banking regulations require commercial banks to meet the minimum charter capital requirement of VND1,000 billion by the end of 2008 and VND3,000 billion² by the end of 2010, although the State Bank of Vietnam has since relaxed this deadline to allow banks more time to meet this requirement. In addition, the regulators have issued warnings that the minimum charter capital will be increased to VND5,000 billion in 2012 and VND10,000 billion in 2015. At the end of 2010, more than half of the joint stock commercial banks did not meet the applicable minimum charter capital requirement.

The banking market in Vietnam is overcrowded. As of December 31, 2010, there were thirty-seven joint stock banks, five state-owned banks, forty-eight foreign bank branches, five joint venture banks, five 100 percent-owned foreign banks, and various finance and finance leasing companies operating in Vietnam. Most small banks are struggling to find their own niche and differentiation. Credit institutions are operating in an unstable

² The applicable minimum charter capital requirement as of the end of 2010 is approximately US\$145 million, based on the exchange rate of USD1: VND20,693.

macro environment caused by trade imbalances, depreciation of the Vietnam dong against the US dollar, and a high interest rate environment. There is significant competition between local banks to attract deposit base. As many borrowers are affected by the economic downturn, the level of nonperforming loans may increase, resulting in more pressure on the banks. During 2006 and 2007, many commercial banks and other credit institutions expanded their business into real estate, and most loans were for investments in real estate or are secured by real estate assets. As such, bad loans may increase because of the banking sector being overexposed to the real estate sector, which is in a downturn with an uncertain recovery prospect. There is also a serious lack of qualified personnel, especially at smaller banks.

Challenges Facing Securities Companies and Investment Funds

Securities companies are affected by the consistently low trading volume on the stock markets and the overcrowded market that affects brokerage fees. The market's downward trend causes losses in proprietary trade activities. There is a lack of qualified personnel and deal opportunities to generate advisory fees. Securities companies are also under pressure from consolidation and/or players leaving the industry. Investment funds are operating in a seriously challenging fundraising environment, and the unstable macro environment affects the performance of portfolio companies. On the other hand, the depressed market presents investors with good opportunities to buy cheap if the funds have cash available.

Countermeasures for Financial Difficulties

Commercial banks utilize various strategies to attract deposits. Many banks offer higher and negotiable interest rates to customers who place large deposits, or they sweeten the deal with freebies. For example, some banks offer on a case-by-case basis interest rates that are higher than the ceiling interest rate prescribed by the State Bank of Vietnam, or offer the maximum interest rate coupled with promotional gifts and complimentary services, such as giving deposit customers more flexibility to purchase foreign currency. Several small commercial banks have been fined or warned for offering interest rates that are higher than the ceiling deposit

rate prescribed by the State Bank of Vietnam. As the regulators increase the level of supervision and prescribe stricter regulations, credit institutions have become more conservative in lending and are shifting their focus to expansion of their branch network and rethinking their strategies. Some securities firms decided to withdraw operation in the securities sector, restructure their operations, and focus on investment activities.

Planning for Financial Obstacles in the Vietnamese Economy

Obstacles may be tracked by closely following changes in macro policies and maintaining close dialogue with regulators. Such dialogue can be conducted via public channel, such as where regulators such as the State Bank of Vietnam and the State Securities Commission have engaged the public in consultation with respect to proposed regulations. Companies in the banking and finance industry and law firms providing services in this area may leverage the close working relationship with relevant regulators to initiate dialogue on matters that arise in practice, through which they can have a better view of the regulators' approach (although unofficial) or developments that are relevant to their business or clients' transactions. To plan for the obstacles, companies operating in the banking and finance sector must also improve their risk management practice with the view to establish a system and processes that meet the regulatory requirements and are appropriate for their operations. Measures that can be taken include reassessing their financial, operational, and information technology risks, closely following prudential guidelines prescribed by regulators, and implementing and maintaining an appropriate information technology infrastructure that can assist with risk exposure assessment and analysis, and strengthen the capability of internal auditor.

Lawyers may assist their clients with these issues by having a firm understanding of the legal requirements, being able to anticipate the commercial and legal issues that may arise, and keeping close communication and working relationships with regulators. On emerging or unprecedented issues, lawyers must take an active role in crafting proposed solutions for regulators, and then ensure that the regulators have a firm understanding of the legal issues.

Conclusion

While the complexity of transactions and clients' higher expectations of lawyers' performance are stress-testing the capabilities and resources of law firms in Vietnam, they also present enormous opportunities to develop local practitioners' practical experience, especially on cross-border deals. We transfer knowledge internally in our firm to ensure that our practitioners benefit from the experience gained from transactions in which we have participated or are developing. It is more important than ever to maintain and improve communication with clients in order to better understand clients' businesses and address their concerns. Lawyers must also be able to anticipate and prepare for the changes in the economic and regulatory environment, which affect client needs. I expect law firms in Vietnam will continue to develop their banking and finance practice along with the maturity of the Vietnamese banking and finance industry.

Key Takeaways

- Open a dialogue with regulators to seek clarifications and policy guidance on issues that are not clear-cut or for which there is no precedent. The Vietnamese regulatory environment is in flux, and there is opportunity to positively affect new laws.
- Counsel investor clients to be mindful of the challenges presented by the complex but ineffective legal and administration frameworks in the banking and finance areas. This weak system causes contradictions in laws and complications in actual deals.
- Assist your client with navigating the Vietnamese system by understanding legal requirements, anticipating commercial and legal issues that may arise, and keeping in close communication with regulators.
- Assume an active role when unprecedented or emerging issues present themselves. Provide the regulators with potential solutions, and then ensure that they understand the related legal issues to improve the probability of a positive result.

Related Resources

Websites of relevant State agencies in Vietnam:

- The State Bank of Vietnam: www.sbv.gov.vn
- The State Securities Commission of Vietnam: www.ssc.gov.vn
- The Ministry of Finance: www.mof.gov.vn
- The Ministry of Planning and Investment: www.mpi.gov.vn

Truong Nhat Quang, managing partner of YKVN, heads a corporate practice focused on banking, capital markets, and merger and acquisition transactions. He has successfully handled landmark deals in Vietnam, regularly advising on complex lending and borrowing issues as well as representing government agencies and multilateral organizations on nation-shaping industrial projects. His clients include top Vietnamese banks and corporations, global investment banks, banks active in Vietnam, and global private equity funds.

Listed by Chambers Asia as a Band 1 (the highest band) lawyer in banking and finance as well as projects in Vietnam for the past three years, Mr. Quang is also regarded as one of Vietnam's finest capital markets practitioners per Chambers Asia 2009.

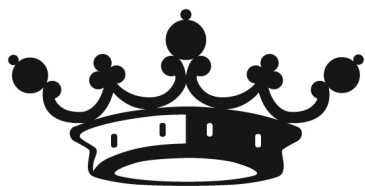
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