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Sector insight

Resolution on Addressing NPLs and Amendment and Supplement of Credit Institutions Legislation

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Effect Evaluation

The National Assembly approved the resolution on addressing non-performing loans (NPLs) on June 21st, 2017 (86% approval). This is one of the most important document which will have a great positive impact on the whole economy. Via banking system (especially via banks own large NPLs and large collaterals), dealing with NPLs helps releasing the outstanding capital and assets (NPLs accounted for 10.08% outstanding debt and 13% GDP). As Vietnam depends heavily on credit, this will accelerate growth, increase efficiency and reduce overall costs for the economy.

The scale of bad debt and the progress of NPLs processing

• Large NPLs (including on balance sheet loans, non-processing loans sold to VAMC and latent debt) reached nearly VND600 trillion is equivalent to 10.08% of total outstanding loans and 13.3% of Vietnam's GDP at the end of 2016, and roughly equivalent to processed NPLs for the five years from 2012 to 2016 of the banking sector (VND 616.7 trillion), including debts sold to VAMC.

• New NPLs arises 1.3% to 1.5% on average annually, Governor of the Bank stated.

• **Processing bad debts takes too long**. The whole systems processed about VND122 trillion bad debt on average for 4 years. In order to process the debts, the bank may (1) Use the loan loss provision; (2) Seize and sell collaterals; (3) File lawsuits; (4) Sell debts to VAMC. These processes usually take quite a long time.

Highlights of the Addressing NPLs resolution:

• In effect as of August 15th, 2017 and valid for 5 years, is the highest legislation in dealing with bad debts and collateral.

• Not using the state budget to process bad debt

• Creating a mechanism for banks to deal with NPLs: (1) the right to seize collaterals, (2) the procedures for settling disputes related to collaterals, (3) Allowing organizations or individuals, who do not have the authorities to deal in debts, purchase and sell bad debts; (4) Allowing debts trading at market prices, which may be higher or lower than book values; (5) Allocation of accrued interest, losses on sale of bad debts of credit institutions (CIs), etc.

• Dealing with bad debts of all credit institution, regardless they are bad debts of weak CIs or not, dealing with bad debts arises from loans incurred before August 15th, 2017.

Important adjustments in Amendment and Supplement of the Legislation of Credit Institutions resolution:

• More clarification on the identification, authorities and mechanism of dealing with weak CIs. To reduce financial pressure on weak CIs:

- Creating separate operating mechanism and financial support for weak CIs
- Regulating on refinancing loans, special loans

• Mechanism of responsibilities and privilege of designate credit, supporting CIs; Liabilities exemption for individuals participate in handling weak CIs.

NPLs and Handling NPLs Situation in Vietnam

The total value of NPLs, latent bad debts and debts sold to VAMC accounts for 10.08% of outstanding loans and 13.3% of Vietnam's GDP in 2016. By the end of 2016, the Central Bank estimated the NPL ratio is 2.52% equivalent to VND150 trillion bad debt. The bad debt on the balance sheet, the non-processing bad debt sold to VAMC and the latent bad debt reached 10.08% of total outstanding loans of the economy, or about VND599 trillion, equivalent to 13.3% GDP of Vietnam.

The bad debts continue to arise and new NPLs add up to 1.3% to 1.5% outstanding loans on average annually as stated in Governor of the Bank Le Minh Hung's report at the XIV National Assembly. According to the governor, with an annual growth target of 16%, it is expected that in next five years, there will be about VND350 trillion more bad debt.

	Value (in VND trillions)
2016 Credit Outstanding	**5,592**
NPLs CIs processed by their own 2012-2016	**349.7**
Latent Bad Debts (in Group 1+2)	254
On-Balance-Sheet NPLs (Group 3+4+5)	150
Bad Debts Sold To VAMC	195
Total in 2016	**599**
% Oustanding Loan	10.08%
% GDP	13.3%
Unrecovered Off-Balance-Sheet Loans	???
Estimated Annual Credit Growth Rate	**16-18%**
Estimated Annual Bad Debt Growth Rate	**10%**
Estimated Annual GDP Growth Rate	**6-7%**

Source: Governor of SBV's report at 14^{th} National Assembly, BSC research

On average, the system is able to process VND122 trillion of bad debt annually. Confronting with the large re-estimated bad debt in 2012, the State Bank of Vietnam (SBV) and the Government have made great efforts in dealing with bad debt and issued many legislations to support the process of dealing with NPLs and restructuring weak CIs. In the period from 2012 to January 2017, the whole banking sector processed VND616.7 trillion, equivalent to the whole sector's bad debt including latent debts and NPLs sold to VACM in 2016, of which self-processed bad debt is 349.7 trillion. Noted that in 2014 and 2015, the size of NPLs increased partly due to the aggressive sale of debts to VAMC during this period.

Of VND122 trillion bad debt the whole system processes annually, self-processed NPLs by CIs accounts for about VND70 trillion. After four years of operation, VAMC processed only VND53 trillion NPLs in total, equivalent to 16% of NPLs sold to VAMC.

Processed NPLs of Vietnam 2012 - Jan 2017

	2012	2013	2014	2015	2016	T1/2017	2017E	Total
Processed NPLs	74.68	87.98	143.55	186.89	118.49	5.14		**616.7**

Source: SBV's Legislator Report

The bad debt processing takes too long. The longer the bad debt processing is, the more unprofitable asset erodes the bank system, as the banks have to pay the funding cost but cannot lend out. Additionally, the value of collateral assets and the debts decreases, thus affecting the recoverable value of the loans. When a loan is determined to be overdue, in order to process the loan, the bank may **(1) use loan loss provision; (2) seize and sell collaterals; (3) file lawsuits; (4) sell the loan to VAMC.** These processes of the banks usually take a very long time.

- **Using loan loss provisions**: According to Circular 02/2014 / TT-NHNN, credit institutions are allowed to use provisions to deal with risks in two cases. (1) Debts are classified as Type 5, (2) Customers are dissolved or bankrupted organizations or; Individuals are dead or missing. So generally the bank is allowed to make the provision to deal with bad debt only after one year from the date when the customer incurred overdue debt/interest or Type 5 classified debts. In order to be able to handle NPLs in this one year, the bank needs a great financial resources. In order to deal with VND599 trillion of bad debts and latent debts and debts sold to VAMC, the loan loss provision expense is estimated to be equivalent to about 6 years of pre-provision profit of the Vietnam Credit Institutions system.
- **Seizing collaterals**. Credit institutions or VAMC cannot proactively seize collaterals if the property owners deliberately oppose or create other disputes related to the collaterals. Especially after the 2015 Civil Code has removed the authority to seize collateral of the collateral collectors even though this authority is still affirm in the decrees and circulars of the banking industry.
- **Taking legal action.** Time to settle the debt and collaterals through the court may last from 2 to 7 years, although the time of litigation according on theory is not more than 400 days. Moreover, the legal costs account for about 29% of the total value of the debt[1] (excluding other costs related to taxes on the transfer of assets, obligations to the state budget, etc.), the judicial quality index in Vietnam was only

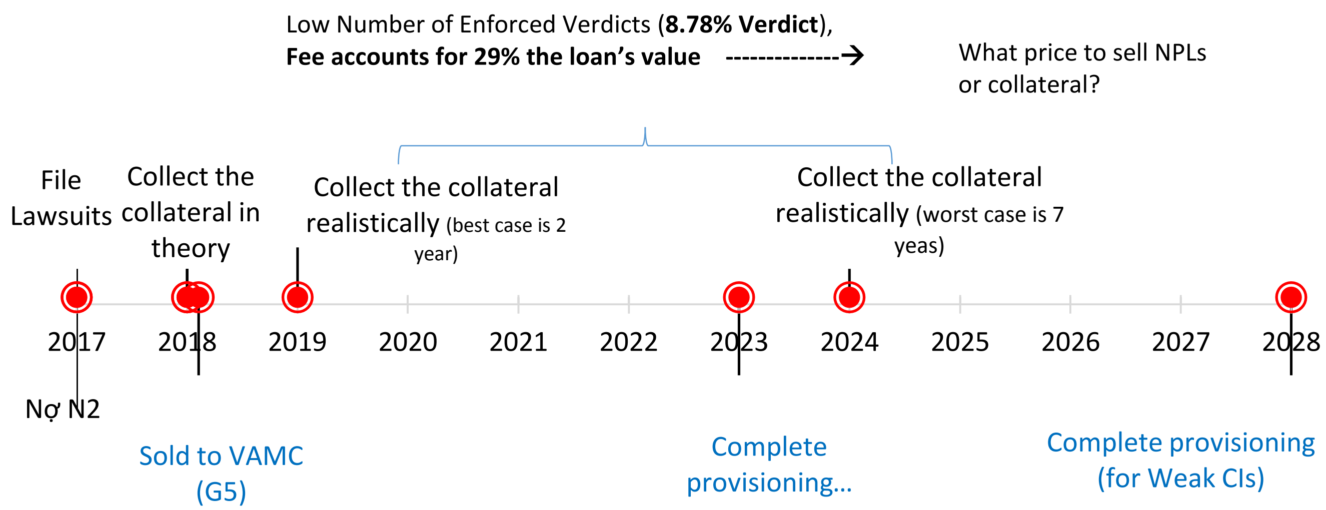
[1] Legislator

6.5 / 18[2]. In many cases, despite the ruling of the court, the number of enforced verdicts is very low, accounting for only 8.78% of the total number of verdicts.

- **Selling collaterals or selling debts**. Current legal regulations allow CIs, authorized organizations to buy and sell debt as agreed, however, there is no clear mechanism to determine negotiating prices, compare with book value etc. Moreover, allowing only authorized organizations participate in NPLs trading (AMC of the bank, VAMC and DATC), in addition to the specific characteristics of these organizations, the debt trading market is not really developed and monopolistic, and therefore the value of debt recovery from the sale may not be high.

- **Selling debt to VAMC, receiving special bonds**. In this case, the value of bonds is accrued in 5 years for normal credit institutions and 10 years for weak ones and some cases approved by SBV. If the bad loans sold to VAMC are recovered, the process of bad debt of the banks may be shortened. However, for four years from 2013-2016, the total recovered value of NPLs sold to VAMC was low, reached VND53 trillion, accounting for about 16% of outstanding loans sold to VAMC. This due to VAMC has insufficient capital and human resources for dealing with bad debts and for supervising and delegating banks to deal with bad debts. Additionally, for some collaterals that are land use rights and assets attached to land, VAMC cannot collect collaterals so VAMC has difficulties to sell or delegate credit institutions to process those debts guaranteed by those collaterals. This also extends the time to process bad debts of banks via VAMC.

Diagram illustrating debt processing process of CIs



Source: BSC research *Note: Hypothetically the NPLs arose in 2017*

[2] Doing business 2017 from WB

Given the large scale of growing NPLs, if we continue to keep current rate of processing NPLs, we estimate that Vietnam may take 8-10 years to deal with current bad debts. Credit flow is not loosened up, not only the banks but also the businesses and the economy are negatively impacted, hindering the Government and the State Bank's objective of economic growth and reducing the interest rate.

Addressing NPLs Resolution

In order to accelerate the process of dealing with bad debts, the National Assembly has separated the contents of addressing NPLs in the "The Law on support to restructure weak CIs and deal with bad debt" resolution. That sped up the discussion process and the Resolution was passed and adopted faster. **The resolution will take effect on August 15th, 2017 and be valid for 5 years. This is the highest legislation to deal with bad debts and collaterals.**

Principles of dealing with bad debt: (1) Not using state budget to process bad debts; (2) The resolution created a mechanism for banks to process bad debts; (3) Resolution applies to NPLs of all credit institutions, regardless of NPLs of weak CIs and other CIs. Thus, the result of dealing with bad debt of each CI depends on its own ability and experience.

Once approved, the resolution on NPLs will accelerate the process of dealing with bad loans and collateral of CIs through:

- **Affirming the authority to seize collateral assets of the credit institutions and the collateral collectors**. If the asset holder fails to deliver assets to the CIs, the foreign bank branches, the debt trading organizations, these organizations are entitled to seize collateral. In addition, in order to ensure the legitimate rights and interests of credit institutions and debt trading organizations the resolution also stipulates: *"Agencies with the authorities to register property ownership and property use rights shall have the responsibility to carry out the procedures for the transfer of property ownership and property use right to the purchaser or collector of collateral of the bad debt of the credit institution or foreign bank branch without requesting a valid document verifies guarantor has fulfilled the tax obligations related to the transfer of the collateral."* This is expected to solve the biggest obstacle in the process of seizing collateral of credit institutions, as well as help banks clear up the asset faster and with higher prices. We consider this is the most positive aspect of this NPLs resolution.

  Moreover, the resolution also allows the purchaser of the debts, which originated from bad debts of credit institutions, are entitled to receive registration of land use rights, assets attached to land which are the collaterals of the purchased debt. Thereby it solves problems related to the loans, which have collaterals that are land use rights, have been sold to VAMC and other debt purchasers. The resolution also resolves the problems in accordance with the current law relating to bad debts sold to VAMC whose collaterals are real estate project or property formed from the real estate projects in the future, "*Infrastructure works in accordance with the approved project schedule",* or the investor does not have sufficient "*land use right certificate for the whole or part of the transfer project".*

- **Implementing the expedited procedures for the settlement of disputes relating to collateral**. Noted that the application of these procedures is only applicable to disputes relating to collateral of CIs, foreign bank branches and organizations deal in bad debts. The current regulations have allowed the CIs and the court to apply the expedited procedure for bad debts with adequate profiles, and valued at less than VND500 million. However, we believe that this value is very small compared to the actual scale of many bad debts of Vietnam. **With the application of the provisions of the legislation, the process of solving common civil cases is shorten by 3-7 months.**

- **The organizations authorized to deal in and processing NPLs are allowed to trade NPLs and collateral at market price which may be lower or higher than the book value of NPLs.** This has been reaffirmed and emphasized in the resolution, thereby waive the liability of the credit institutions, individuals and organizations processing bad debts if bad debt are sold lower than the book value of the debt.
- **Expand the market participators for bad debt trading**, allowing organizations deal in and process bad debts to sell bad debts to legal entities and individuals, including legal entities and individuals without authorities to deal in debts. Thereby, we expect the higher selling price of bad debt and collateral with faster processing time.
- **Allowing the allocation of accrued interest and the difference between the book value of the debt and the selling price of debt in 5-10 years**. The accrued interest before December 31st, 2016 is allowed to allocate in no more than 10 years. Also, the resolution allows the allocation of difference between the book value of the debt and the selling price of debt in no longer than five years. Thereby it reduces the financial burden on credit institutions with large accumulated accrued interest and debts sold below book value.

With the mechanisms mentioned in the resolution, despite many positive points, in our opinion, these regulations still require more guiding documents to form open debts market that is transparent and attractive enough for investors.

Amendment and Supplement on Credit Institutions Legislation Resolution

As mentioned above, the resolution of "*The Law on supporting the restructure of weak CIs and process of bad debts*" is divided into two parts at the 14th National Assembly as "*Addressing bad debt resolution" And " Amendment and Supplement on Credit Institutions Legislation resolution*". Main content of the resolution relates to the restructure of weak CIs.

After 4 years of implementing the project "Restructuring CIs for the period 2011-2015" under Decision No. 254 / QD-TTg, weak CIs were identified and restructured. The SBV bought three commercial banks at the price of VND 0, added another commercial bank to the special surveillance, and merged and consolidated other banks and credit institutions, reduced the number of CIs by 22. However, the restructuring process of weak CIs still has many problems:

- Due to the incomplete and inadequate legal framework for the processing of credit institutions, there are many shortcomings, such as the compulsory purchase of some weak CIs at VND0, have caused controversy. Currently SBV does not have authority to compulsory dissolute weak CIs which are incapable of recover.
- Slow recovery and restructuring of weak CIs. Poor CIs have financial difficulties, do not meet the requirements of safety in banking operations. Additionally, the Law on Credit Institutions 2010 does not yet have any specific regulations on operation of these credit institutions, even many activities of these credit institutions are tightened under the regulations on supervision and administration of the State, thereby increasing the operating cost of these CIs. The bad debt and collateral issues still face many obstructs in processing, causing the financial situation of CIs to become more severe and difficult to recover.
- There is no legal regulation to specify the rights and responsibilities of supporting banks or organizations appointed to participate in restructuring weak CIs. There is no mechanism for waiving liability and regulating the interests of staff involved in handling and restructuring CIs.

The Resolution on Amending and Supplementing of Credit Institutions Legislation provides more detailed regulations on determination, mechanism and jurisdiction for handling weak as well as proposes more realistic recovery plan and financial support. We do not expect the operation of weak CIs to be profitable in the early years, but their performance is expected to recover. Also identifying early and dealing correctly with weaknesses of these CIs will help strengthening and stabilizing operation of the whole banking system. A few new items of the resolution:

- **Regulating more precisely on the identification of weak CIs** (Credit Institutions placed under special supervision of the SBV). In particular, there are additional provisions on issue of the Board of Directors, Board members or General Manager (Director) violates the law, credit institutions lose their solvency, and other cases according to the conclusion of the Banking Supervision Agency or at the request of CI. Thus, the new regulation is more clearly defined and closely associated with the role of the bank manager or operator.

- **Defining more precisely the mechanism for handling weak credit institutions and the handling authorization** with the participation of commercial banks, special supervision boards, the SBV and the Government. In particular, stating clearly (1) the plan for treating a weak CI includes the plan for handling the legal entity (merger, consolidation, sale of the entire charter capital, dissolution, bankruptcy) or compulsory acquisition (buy shares for VND0); (2) recovery plan.
- **Introducing solutions to support weak CIs operationally and financially, thereby reducing financial pressure and gradually stabilizing operations of these credit institutions**.
  - ➢ During the period of special supervision, weak CIs do not have to comply with regulations of the SBV on safety limits, safety ratios in banking operations, and provision for loss.

  - ➢ Allowing to sell unqualified bad debts or bad debts with seized collateral assets under VAMC regulations, to exempt or reduce required reserve ratios and to gradually account into expenses the difference between the selling prices of debts /Receivables / Investments with the book value of the above items for a maximum of 10 years, provision is made in accordance with the operating result of that CI. This will reduce significantly financial pressure and funding costs for weak CIs. Weak credit institutions, which are compulsory purchased, may be financed by the Government with additional capital, long-term loans at 0% interest rate (instead of current short-term loans) etc.
- **Mechanisms on authorities and responsibilities of designated credit institutions, supporting CIs, exemption from liability for individuals involved in dealing with weak CIs;** thereby creating motivation to encourage individuals and organizations to participate in the restructuring of weak CIs.

Evaluate the Impact of NPLs Resolution to Commercial Banks

As mentioned above, the resolution creates mechanisms for all credit institutions to handle NPLs and collaterals, therefore, the impact of the resolution is on all credit institutions. However, to assess the impact of the resolution, we consider two aspects: (1) the absolute and relative scale of bad debt and latent debt; (2) Capability and experience in handling bad debts of commercial banks.

In terms of scale, we expect the resolution will have a strong impact on the group of commercial banks with on and off balance sheet NPLs, NPLs sold to VAMC, high interest and fees and group with large collateral. Some large banks such as STB, BID, CTG and some banks have a high ratio of those asset on outstanding loan such as STB, VPB, SHB and EIB.

In addition, the resolution has a positive impact on the whole banking sector, thereby releasing the locked up capital / assets to the economy (NPLs are accounted for 10.08% outstanding debt and 13% GDP). Therefore, this will accelerate growth, increase efficiency and reduce overall costs for the economy.

Loan and Collateral Balance of Banks Q1/2017

In VND

	VCB	CTG	BID	MBB	ACB	STB	SHB	EIB	NVB	VIB	TCB	VPB
Type 2 Loan	7,162	9,157	28,864	2,429	2,164	3,446	2,289	659	2,119	711	3,627	10,161
NPLs	7,377	7,917	16,251	2,020	1,908	10,083	3,303	2,589	473	1,391	2,601	5,326
Net VAMC Bond	-	6,541	14,773	4,479	1,069	36,136	6,628	5,620	5,802	1,878	407	3,440
Interest/Fee Receivable	5,545	14,401	9,510	2,626	2,725	26,009	8,367	1,084	3,228	1,042	4,440	3,993
Total	**20,084**	**38,016**	**69,397**	**11,554**	**7,866**	**75,674**	**20,588**	**9,952**	**11,622**	**5,022**	**11,075**	**22,919**
% Outstanding Loan	4.02%	5.45%	9.15%	7.63%	4.47%	36.67%	11.96%	11.51%	44.33%	7.90%	8.04%	15.06%
Collateral BV	**678,531**	**1,247,926**	**954,707**	**484,433**	**327,510**	**372,067**	**384,526**	**171,966**	**85,005**	**171,041**	**391,783**	**340,636**
%Outstanding Loans	**136%**	**179%**	**126%**	**320%**	**186%**	**180%**	**223%**	**199%**	**324%**	**269%**	**284%**	**224%**

Source: Companies' Reports, BSC research

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