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# Bad debts in Vietnam

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## Bad debts in Vietnam

Nguyen Tuan Anh  
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**Abstract**

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As nonperforming loans can negatively impact the health of economic environment, bad debt is viewed as a serious threat to any economies, especially for those of developing countries. In case of Vietnam, it is one of the most discussed matters by both the public and the officials. Topics regarding bad debt and restructuring banking system are densely presented on several media channels.

The objective of the thesis is to investigate the current situation of nonperforming loans in Vietnam and provide suggestions based on precedent approaches. From the particular research, readers are expected to have further insights into the phenomenon and the actual experience in Vietnam.

The paper is written based on information of previous research works, which are conducted by international or local economists and experts. Furthermore, current approach and policies issued by the State Bank of Vietnam are considered to provide a more accurate prospect of the economy.

Keywords: bad debt, nonperforming loan, impairment loan, loan resolution, Vietnam

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## GLOSSARY

AMC	Asset Management Company
CAR	Capital Adequacy Ratio
CIC	Credit Information Center
CRC	Corporate Restructuring Company
FDI	Foreign Direct Investment
IIF	Institute of International Finance
IMF	International Monetary Fund
KAMCO	Korea Asset Management Company
KDB	Korea Development Bank
KDIC	Korea Deposit Insurance Corporation
LDR	Loan-to-Deposit Ratio
MOFE	Ministry of Finance and Economy
NPL	Non-performing Loan
SBV	State Bank of Vietnam
USD	United States Dollar
VAMC	Vietnam Asset Management Company
VND	Vietnam Dong, Vietnamese currency

## 1 Introduction

In this chapter, an overview of the dissertation's development is presented. The first part introduces the reasons for conducting the paper. The second part includes the research objective and research questions, which are followed by an explanation of the theoretical framework and research methodology. Finally, this chapter is concluded by an illustration of the structure of the thesis.

### 1.1. Background

While the worst bad debt rates recorded were 11.4%, 17.8% and 50% in Malaysia, Korea and Thailand respectively, Vietnamese economy showed no signs of negative impacts from the Asia Financial Crisis in 1997. On the contrary, Vietnam was enjoying outstanding economic growth rates while its neighbors fought hard against bad debts. Yet, only recently, when bad debt was only disclosed as one digit percent, several reputed international credit rating agencies such as Moody's and Fitch Group still retained their assessment that bad debt rate could be much higher. They believed that nonperforming loans (NPLs) in Vietnam's banking sector was yet to fully uncover.

In 2011, for the first time, the State Bank of Vietnam (SBV) took the initiative to disclose NPL ratio within banking sector. Accordingly, the NPL ratio was estimated at 3.8 percent of total outstanding loans. Also in the same year, credit growth was recorded at only 12 percent, lowest in 10 years' time of enjoying credit boom. GDP growth was not better, reaching below 6 percent for a second time since 2009.

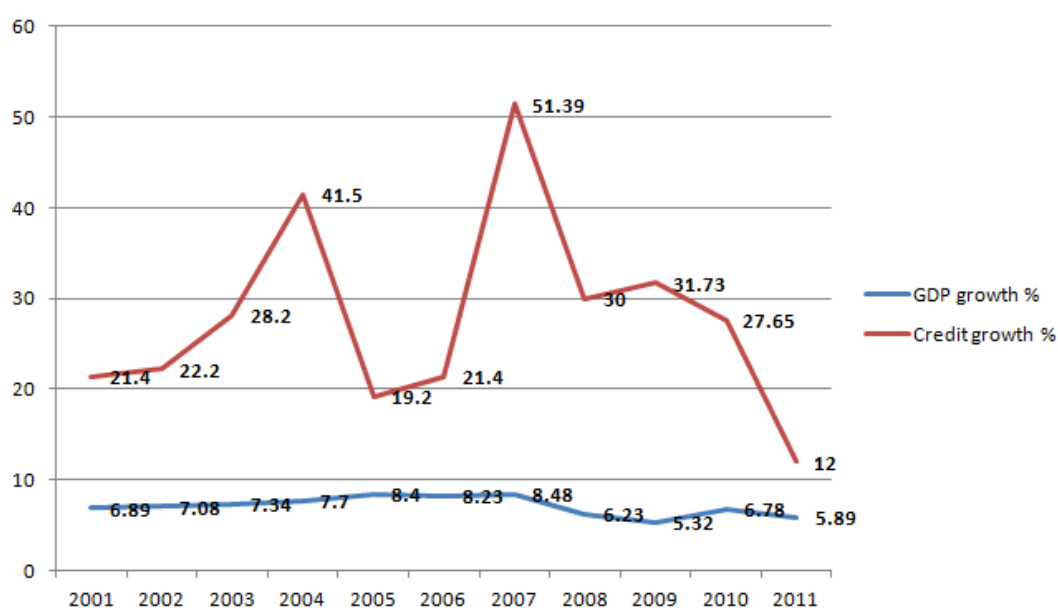


Figure 1: GDP and credit growth rate in Vietnam between 2001 and 2011 (Pham, n.d.)

In July 2012, while NPLs was published at only 3.4 percent, the governor of the SBV Mr. Binh unexpectedly admitted that the real figure could be around 10 percent. Consequently, in September 2012, Moody's downgraded Vietnam credit rating from B1 to B2; the rationale provided was "intensification of banking system vulnerabilities" from "a prolonged credit boom" and the recent "tightening in policy" (Global Credit Research 2012). Also in the research, the necessity of "bank restructuring plan" and "improvement in transparency or governance" was also addressed for positive rating action.

Vietnam's government has been proactive in loan resolution, as represented by the establishment of Vietnam Asset Management Company (VAMC), and easing of contingent credit risks by implementing tightening policies. Yet, it is still unknown whether the series of initiatives really solve the instability in Vietnamese economy.

## 1.2 Research objectives and questions

The rationale for the thesis is to research the bad debt situation in Vietnam, and the government's initiatives in loan resolution. The purpose is to propose some suggestions as countermeasures against the occurrence of bad debt, and as recommendation for the improvement of Vietnam Asset Management Company (VAMC). Accompanied by the case studies of Korea's KAMCO and Malaysia's Danaharta, their experience in debt disposition is invaluable for current state of Vietnamese economy.

The drives of the study are listed as the following questions. The first two questions focus on the impaired loan resolution as case study, while the third one concerns current situation in Vietnam:

1. What is bad debt, its causes and consequences?
2. How could the impairment loan be controlled in precedent cases?
3. What has been done by Vietnam's government in asset resolution?

## 1.3 Limitations

The first limitation of the dissertation is insufficient data and statistics. Poor transparency in disclosure of credit institutions' reports restricts the accuracy of statistics. Those presented in this study are closest estimations based on available resources and in accordance with the nearest implementation of the government's policies.

Due to political issues, coherence and transparency in Vietnam's disclosure are lacking. Fig-



ures, numbers, charts and so on, which are provided in the research, are closest estimations published in local media channels.

As the fundamentals of the paper cover the nonperforming loan situation in Vietnam and the establishment of VAMC as countermeasures, other precedent approaches and policies will be overlooked. Those previous policies will be considered as foundation for the discussion in this dissertation.

#### 1.4 Methodology

The research approach used in the research is deductive. The aim is propose suggestions based on precedent cases on loan settlement in Vietnam. Therefore, in the first chapter of this paper, terminologies and various related factors will be provided, as the theoretical framework of further research in case studies.

As for data gathering and analysis method, qualitative method is more appropriate for the particular dissertation's objective. Based on case studies and interviews, recommendations for bad debt resolution in Vietnam will be comprised in the lattermost of this thesis.

With the intention of providing objective results, the scope of data collection is solely secondary resources, including books, research papers, disclosure, reports, and so on. Primary data is extracted from interviews with current banking officers.

#### 1.5 Structure of the dissertation

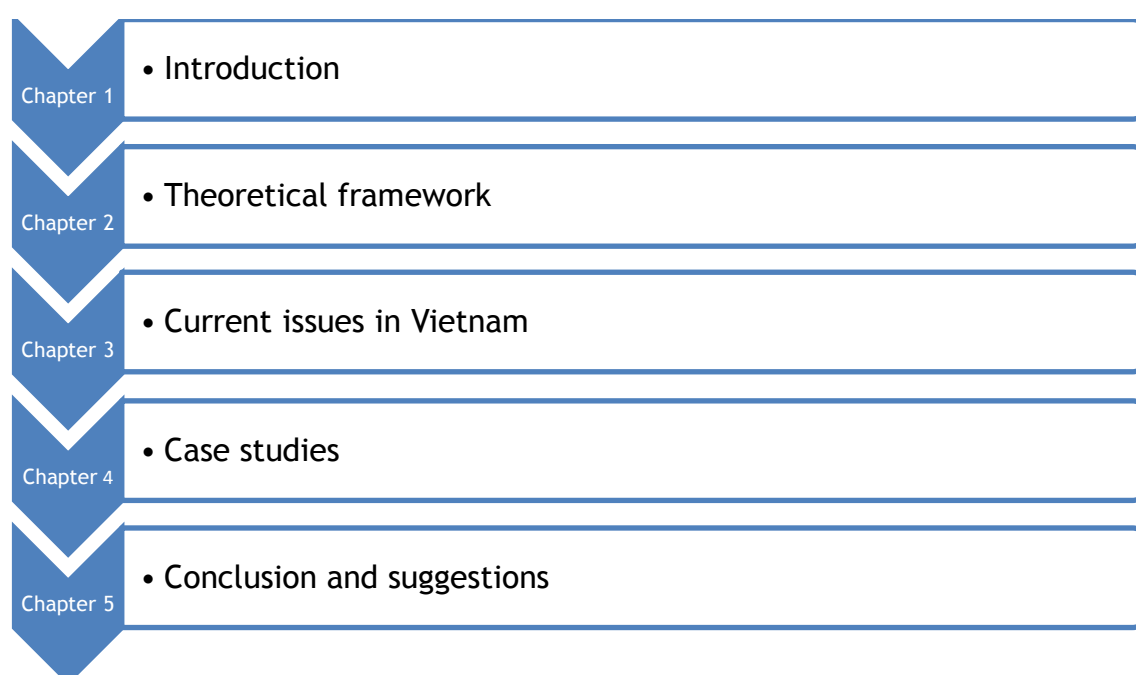


Figure 2: Structure of the dissertation

The paper covers five main chapters. The first chapter provides readers with an overview of the thesis, comprising dissertation's objectives and questions, methodology and the flow of chapters. The second chapter presents the explanation of terminologies, literature on causes and impacts of nonperforming loans, approaches to debt settlement and Asset Management Company's role in loan resolution. In the third chapter, an overview of Vietnamese current issues is addressed, followed by case studies of Korea's and Malaysia's asset management companies. The dissertation is concluded by presenting some recommendations on Vietnamese approach to nonperforming loans.

## 2 Understanding bad debts

### 2.1 Theories of performing and non-performing loans

According to Oxford's Dictionary of Finance and Banking, bad debt is defined as an amount owed by a debtor that is unlikely to be paid due to; for example, a company going into liquidation (2008, 31). Accordingly, it is a debt that cannot be reimbursed, or one whose collection would be uneconomical to pursue.

In practice, there is no specific definition of a bad debt or mechanism for resolving bad debts. Therefore, criteria for bad debts and debt settlement solutions may differ from one country to another, depending on its political and economic objectives, policies and regulations. In the subchapter 2.4.3, experiences in resolving bad debts will be discussed further.

The term “bad loans” as defined in Basu (1998), is used interchangeably with nonperforming and impaired loans as interpreted by Fofack (2005). These terms are used equivalently throughout the paper; but one country may describe the term “nonperformance” distinctively, and cause these terms, nonperformance and loan impairment, to be different.

#### 2.1.1 Performing loans

A loan generally refers to a contractual agreement between two entities. In such note, the lender agrees to grant an amount of money to a borrower, who is obligated to reimburse the said amount to the creditor either in one lump sum or in installments over a stated period of time. The contract may also incorporate provision of additional payments, which are, for instances, interest charges, processing fees, commissions, or monitoring fees. Those are usually paid inclusive to the principal granted. A loan may accordingly be recognized as performing if payments of both principal and interest are up to date as promised between the two parties (Francis, 2009).

#### 2.1.2 Nonperforming loans

As mentioned in Clarification and Elaboration of Issues Raised by the December 2004 Meeting of the Advisory Expert Group of the Intersecretariat Working Group on National Accounts, International Monetary Fund (IMF) defines:

A loan is nonperforming when payments of interest and/or principal are past due by 90 days or more, or interest payments equal to 90 days or more have been capitalized, refinanced, or delayed by agreement, or payments are less than 90 days overdue, but there are other good reasons—such as a debtor fil-

ing for bankruptcy—to doubt that payments will be made in full (2005, 8).

Therefore, a bad debt is basically determined based on two factors: (1) overdue by 90 days or more and (2) doubtful repayment possibility. It is essential to understand that different countries may use quantitative or qualitative approach to definition of bad debts. Quantitative criteria are generally based on a fixed number of days of overdue payment, while qualitative norms emphasize the ability of up-to-date repayment. Different approaches to debt recognition may result in various means of resolving bad debts.

### 2.1.3 Classification of bad debts

In *The Treatment of Nonperforming Loans in Macroeconomics Statistics*, categories of loans are mentioned as followed:

Classes	Criteria
<u>Class 1: Standard</u>	<ul style="list-style-type: none"> <li>- All principal and interest payments are current</li> <li>- Repayment difficulties are not foreseen</li> </ul>
<u>Class 2: Watch</u>	<ul style="list-style-type: none"> <li>- Required more attention for full repayment</li> </ul>
<u>Class 3: Substandard</u>	<ul style="list-style-type: none"> <li>- Doubtful ability of full repayment, and/or</li> <li>- Interest and/or principal are overdue more than 90 days</li> </ul>
<u>Class 4: Doubtful</u>	<ul style="list-style-type: none"> <li>- Full collection is determined as improbable</li> <li>- Interest and/or principal are overdue more than 180 days</li> </ul>
<u>Class 5: Loss</u>	<ul style="list-style-type: none"> <li>- Loan is virtually uncollectible</li> <li>- Interest and/or principle are overdue more than one year</li> </ul>

Table 1: Class of debts proposed by IIF (Adriaan & Cornelis, 2001)

It is also noted that cases of (1) loans being irretrievable completely and (2) loans being impaired (Class 3 Substandard and class 4 Doubtful) are generally expected to be uncollectible (2001, 8). Hence, these two cases are considered as “nonperformance loans” or “impairment loans”, while class 1 Standard and class 2 Watch may be viewed as “performing loans”.

### 2.2 Causes of bad debts

Generally, there are five main elements that may trigger nonperforming loans or NPLs (Ha, 2008):

### 2.2.1 Inevitable factors

Those can be natural disasters (for examples, hurricanes, earthquakes, fires, and floods), changes in customers' demands, wars, strikes, or constant discounts for competitive advantage. Such reasons may affect the borrower's liquidity; therefore, if pressed for repayment, it is likely that debtor will file for bankruptcy. Ultimately, credit institutions, as creditors, will bear losses as loan impairment.

### 2.2.2 Poor transparency of information

The lending-borrowing activity of banking's operations will proceed smoothly under the assumption that entities, creditor and debtor, have full information of each other, especially regarding financial status, business activities and collaterals, or guarantor's ability to reimburse.

Yet, in practice, one party usually obtains less information of the other, which may lead to "moral hazards". The term can be understood as "any situation in which one person makes the decision about how much risk to take, while someone else bears the cost if things go badly" (Krugman, 2009). Under such circumstances, instead of choosing borrowers with high probability of repayment, lenders may grant the loan to "bad" customers, which will later incur impaired loans to creditors. After transactions, debtors may perform activities against previous commitment, which lead to probable loss in business, and become unable to reimburse the loan.

Despite the fact that information is not transparent, financial intermediaries still grant loans to keep their competitive edge and opportunity for profit. Furthermore, according to Keeton and Morris (1987), Berger and DeYoung (1997), and Salas and Saurina (2002), banks, whose relatively low equity-to-assets ratio, are more likely to respond to moral hazard incentives.

However, to increase business efficiency and avoid losses of NPLs, banks should be aware of current information and its trustworthiness in order to process timely and accurately cases of probable bad loans.

### 2.2.3 Inadequate management

The hypothesis is first introduced Berger and DeYoung (1997) during their research of US commercial banks for the period 1985-94. In their research, low cost efficiency is argued as a sign of management malpractices, hence suggesting that NPL rate is probable to increase as a

result of poor loan underwriting, monitoring and control. Later, this hypothesis is supported by Williams (2004), Podpiera and Weil (2007), and Louzis, Vouldis and Metaxas (2010).

In practice, most NPLs are originated from inadequate evaluation phrase of credit officers. By not accurately determining the scope of business, competitiveness of clients in their industries, or revenues, commercial banks may not offer appropriate amount of loans and relevant surveillance manners. Moreover, wrong use of funds is a result of superficial tracking of debtors' use of funds and lack of assessment in their funds' efficiency. Therefore, in case of investment loss, loans become impaired, in other words, bad debts incur.

#### 2.2.4 Economic environment

The relationship between NPLs and economic conditions is supported by Salas and Suarina (2002), Rajan and Dhal (2003), Fofack (2005) and Jimenez and Saurina (2005). The idea is that: when there is an economic downturn, unemployment rate will rise and borrowers encounter greater obstacles in loan reimbursement; therefore, NPLs rate will increase.

The economic environment holds impact on financial status of borrowers, and therefore, influences on the failure or success of lenders. Besides, growth or decline in business cycle affects the profitability of debtors, hence determining the ability of reimbursement. During depression period, depending on its severity, nature or duration, debtors' competence to repay the loans may be adversely affected. The worse the crisis is, the more the purchasing power is limited.

Inflation also has negative effects on business profitability: material costs, transportation fees, labors, etc. Increase in those elements will directly influence the borrowers' liquidity.

Deflation is also unfavorable in business operations; for instances, increase in the customer price index is lower than that of interest rates, which make the clients reserved to apply for loans for production development. In addition, decreased level of manufacturing rate, circulation of goods, capital investment will limit the business profitability. Thus borrowers, while upholding the fixed costs and being obligated to refund complete principal and interests paid for previous business cycle, may become insolvent.

#### 2.2.5 Legal environment

Legal environment of business is a combination of regulatory factors which hold impact on business operations. Such can be legislation system, measures of law enforcement and law execution of legal entities engaged in business and related industries. Different social and

economic conditions require corresponding legal systems. Nevertheless, regardless of economies, legal system must be profoundly established to ensure that business activities - especially credit activities - move in certain orbits. Conversely, it can hamper economic development, business operations, generate chronic debt or deadlock in lending-borrowing relationship.

## 2.3 Bad debts' consequences

In this subchapter, influences of impairment loans on commercial banks and economy will be viewed more closely from commercial banks' and economy's point of view.

### 2.3.1 From commercial banks' perspective

Impairment loan is a problematic issue which requires immediate response to avoid any potential damage. Usually the debt acquisition cannot be processed in a short amount of time; hence, banks will encounter several consequences:

#### 2.3.1.1 Reputation

Banks with high level of NPLs will more or less raise doubts among potential customers (Diawan & Rodrik, 1992). Thus, borrowers may hesitate in engaging to any relationships with those, for concerns of bad management, poor appraisal process, moral hazards, etc. Banks, consequently, cannot raise capital from saving deposit activities.

#### 2.3.1.2 Loan settlements

During the lending-borrowing process, borrowers are normally asked to deposit assets in the bank depending on the value of loan. Those can be real estate (in other words, building, land, houses, etc.), valuable papers (such as shares, bonds, certificates of deposits, etc.), or other types of assets. When the loan is downgraded to impairment loan, the bank will take action to retrieve the loan by settling the collateral. However, the process is not easily conducted based on individual economic conditions (inflation, deflation, low purchasing power, financial crisis, etc. ) and/ or the country' policies.

#### 2.3.1.3 Profitability

When a loan is downgraded to class 3, 4 or 5, as Substandard, Doubtful and Loss respectively, provisions for that also increase. Therefore, in case NPLs account for ample amount of capital, commercial banks will be in shortage of liquidity. When capital is limited, lending activi-

ties are restricted and thus restraining them from making profits. Moreover, clients cannot receive loans for business expansion. This dilemma will also hinder the economic development in the long run.

#### 2.3.1.4 Probability of bankruptcy

As mentioned above, high ratio of NPLs may adversely affect banks' reputation, meaning fewer potential "good" clients are willing to participate in the lending-borrowing relationship. As a result, commercial banks cannot earn profits from lending, and make more losses on carrying impaired assets. Moreover, depending on individual country's policies, those banks may be asked to undergo merger and acquisition relationship with another, or file for bankruptcy. As cited in Berger and De Young (1997), a large proportion of failing banks has bad loan portfolio and asset quality management is also directly linked to solvency probability.

#### 2.3.2 From the economic perspective

Not only significant rate of NPLs causes concerns among ones in the involved country, it also affects the confidence of foreign investors in the economy. High level of impairment loans can be interpreted as inefficiency in fiscal policies, low return on potential investments, poor management on monetary policies, and so on. Therefore, potential investors become more reserved in making transactions, resulting in decline in FDIs.

Moreover, Diawan and Rodrik (1992) support the link between NPLs and low credit growth. As high NPLs rate adversely affects the bank's reputation, limited financing, increase in lending rates, costs of carrying and provisioning impairment loans will contribute to lower credit supply, thus implying disturbance to economic activities (Mohd et al, 2010).

### 2.4 General approaches to bad debt

Bad debts and their resolutions are always a controversial topic for most countries. When NPLs level escalates, that will affect the development of the general economy and its financial system. Therefore, measures to handle and prevent impairment loans are necessary for all countries involved. Depending on specific characteristics of each individual country, approaches to NPLs may vary. In the following discussion, two main patterns for debt settlement will be disclosed: centralization and decentralization model.

#### 2.4.1 Centralization model



This is a model in which the State Bank will play an important role in debt settlement under some specific asset management objectives. By establishing a national agency to handle debts (often called as Asset Management Company, or AMC), its priority is to settle all bad debts from financial intermediaries.

By centralizing all the impaired loans, AMC can benefit from economies of scale, asset securitization, and authority for implementing policies on debt collection and bank restructuring. From banks' point of view, they can also engage in new lending-borrowing relationship with better prospect of profitability, or rebuilding internal systems. Besides, AMC will indirectly help assess correctly banks' value by separating NPLs from distressed ones, allow banks to use their capital in other business operations, hence implying less interference to economic activities.

Nevertheless, AMC will also encounter several difficulties. For instances, collecting debtors' information will be complicated; complexity in managing effectively a high volume of assets may result in decrease of assets' value. Moreover, political interference and lack of competency are also stated in counter-arguments of such pattern (Woo, 2000).

Arguments and counter-arguments concerning this pattern will be examined more closely in subchapter 2.5.

#### 2.4.2 Decentralization model

With this approach, affected banks will tackle NPLs by establishing individual AMC or specialized sectors or AMC founded by private creditors. Thus these AMC will possess full authority for special accounting, fiscal advantages and legislative power.

Its advantage includes complete knowledge base of debtors; and incentives for banks' initiatives in maximizing debt recovery, improving loan monitoring process and organizing loan restructuring. However, limited relationship between banks and enterprises is essential in effective loan settlement. According to IMF (1999), extensive links between financial institutions and corporate partly slowed down the restructuring process in Japan.

According to Klingebiel (n.d.), there are also concerns regarding the approach. Those privately-owned AMCs may be used to increase falsified capital by transferring NPLs at book value, or above market value. Therefore, supervisory committee needs special authority in rule enforcement and intervention in circumstances of possible violations.

Decentralization model will only perform under a well-functioning legal and regulatory

framework, uniform accounting methods with appropriate disclosure under administration of supervisory committee. Moreover, adequate skills and resources are required for financial institutions to resolve debts.

## 2.5 Theories on Asset Management and necessities of Asset Management Company

The focus of this study is primary on centralization approach in debt resolution, meaning establishing centralized AMCs. Theoretical base in this subchapter will provide more insights in such approach and the foundation for further discussion on Vietnam' AMC in chapter 4.

### 2.5.1 Understanding Asset Management

Broadly defined, asset management is a process in which NPLs are recognized and classified, based on individual characteristics, into four classes of actions including selling, recovering, restructuring and write-off. Asset management policies are a set of arrangements or techniques that facilitate such process.

Categories	Criteria	Objectives
Selling	<ul style="list-style-type: none"> <li>- A market for such assets exists/ or be organized</li> </ul>	<ul style="list-style-type: none"> <li>- Restoring liquidity and solvency to financial intermediaries, rehabilitate confidence in their valuation, strengthen credit practices to facilitate financial restructuring</li> <li>- Reassuring creditors of outstanding and new credits, debtors of lower risk premium on interest rates by achieving high rate of rehabilitation</li> <li>- Accelerating the reallocation resources process by immediate resolution of NPLs and ultimately facilitates economic recovery</li> <li>- Indirectly creating market benchmarks for overvalued assets for the purpose</li> </ul>
Recovering	<ul style="list-style-type: none"> <li>- Existing legal framework and procedures to assist legal process to recoup assets' value through seizure and liquidation</li> </ul>	
Restructuring	<ul style="list-style-type: none"> <li>- Redefining terms of the original contract with the intention of bolstering the assets' obligor to eventually reimburse the principal</li> <li>- Only when the value of an asset' recovery exceeds that of its liquidation</li> </ul>	
Write-off	<ul style="list-style-type: none"> <li>- Loss in book value</li> </ul>	

	<p>and removed from balance sheet</p> <ul style="list-style-type: none"> <li>- Only when probability of recovery is low and/ or carrying costs are higher than its original value</li> </ul>	of stabilizing asset markets
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Table 2: Asset Management's categories and its objectives (Woo, 2000)

For its successful implementation, many of those conditions are government-based initiatives:

Categories	Criteria	Objectives
Legal system	<ul style="list-style-type: none"> <li>- Rights of ownership and legal obligations between debtors and creditors for potential resolution over disputed assets are clearly outlined</li> <li>- Providing balanced protection for both lenders and borrowers</li> </ul>	<ul style="list-style-type: none"> <li>- Reducing probability of deliberate default from assets' obligor</li> </ul>
Financial framework of regulations and supervision	<ul style="list-style-type: none"> <li>- Improvement in loan classification system, monitoring, credit assessment</li> <li>- Relevant provisioning approaches</li> </ul>	<ul style="list-style-type: none"> <li>- Facilitating rational decisions in impaired assets' management</li> <li>- Preventing indeterminate time of assets' maintenance, causing the markets of such to be halted</li> </ul>
Tax system	<ul style="list-style-type: none"> <li>- Reduced tax on financial transactions of NPLs' sale, or replaced by tax on income generated on assets' sale</li> <li>- Reduced tax on specific loan loss provision</li> </ul>	<ul style="list-style-type: none"> <li>- Increasing creditors' willingness to tackle nonperforming assets</li> <li>- Facilitating financial transactions and restructuring</li> </ul>
Macroeconomic	<ul style="list-style-type: none"> <li>- Stabilized exchange</li> </ul>	<ul style="list-style-type: none"> <li>- Increasing probability of</li> </ul>

conditions	<p>rate to encourage foreign investors in local asset markets</p> <ul style="list-style-type: none"> <li>- Appropriate interest rate policies to (1) discourage creditors to carry impaired assets for an indefinite time and (2) encourage the sale of those assets</li> </ul>	<p>NPLs' recovery</p> <ul style="list-style-type: none"> <li>- Enhancing assets' attractiveness in investment environment</li> </ul>
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Table 3: Prerequisites for Effective Asset Management Policies (Woo, 2000)

### 2.5.2 Advantages and disadvantages of Asset Management Company

As to facilitate the restructuring of distressed financial institutions and viability of nonperforming assets, country implementing centralization model will have an Asset Management Company (AMC) established. Examples for such approach can be KAMCO, and Danaharta, all of which are mentioned in chapter 4. However, there are several arguments and counter-arguments concerning the importance of AMCs.

Arguments in favor of such approach include these below (Woo, 2000):

- Division of labor: By separating nonperforming assets with performing ones, distressed financial intermediaries can invest their capital in other potentially profitable activities or focus in bank restructuring and the AMC's management board can concentrate on those assets' recovery.
- Facilitation of valuation: By removing NPLs from such financial institutions, potential customers can have a better assessment of banks' value. This factor is essential when banks need to raise funds from the market.
- Enhancing credit discipline: credit officers may approach more proactively towards future loans, as well as unhealthy borrowers whom banks continue the relationship due to connections and lending history.
- Economy of scale: AMCs are able to offer to potential buyers a considerably large volume of assets, especially for ones who prefer to deal with one seller in the market. Besides, AMCs also gain benefits from relatively easier securitization process.
- Increase in bargaining power: In case of scattered collaterals of single debtor in different banks, AMCs create proportionately more pressure towards that individual borrower, especially whose size and dominance are large.

Nevertheless, there are also challenges for those agencies as proposed by Woo (2000):

- Loss in institutional knowledge: Removing NPLs from its original knowledge base will hinder their sale process. Moreover, by having real experience from handling NPLs, credit officials can improve their assessment skills for future activities.
- Diminishing credit discipline: Borrowers are less likely to recoup their loans to AMCs, with which they do not have any previous engagement. Moreover, it is not obligated to repay since debtors will not enter any contractual terms with these agencies for new funding.
- Challenging in assets' valuation: During economic downturn and absence of market benchmarks for assets' price, AMCs will have difficulties in correctly assessing their value.
- Political interference: It is virtually impossible to differentiate political influence and pressure from debtors with the management of national AMCs.
- Lack of competency: It is relatively efficient to build appropriate infrastructure and expertise in handling NPLs within commercial banks than that in AMCs

### 3 Current issues in Vietnam

#### 3.1 Overview of Vietnamese banking sector

The State Bank of Vietnam (SBV) is a government agency operating under Vietnamese administration. The bank governor, who is as well a member of the cabinet, is appointed by the prime minister under the approval of the Parliament. The SBV's missions include:

- Promoting monetary stability and formulating monetary policies
- Promoting institutions' stability and supervising financial institutions
- Providing banking facilities and recommending economic policies to the government
- Providing banking facilities for the financial institutions
- Administering the country's international reserves
- Printing and issuing banknotes
- Overseeing all commercial banks' activities in Vietnam
- Lending the state money to the commercial banks
- Issuing government bonds, organizing bond auctions
- Being in charge of other roles in monetary management and foreign exchange rates (World Bank, 1995)

According to National Financial Supervisory Commission (2011), there are 5 state-owned commercial bank, 35 joint-stock commercial banks, 4 joint venture commercial banks, 51 branch offices of foreign banks, 5 banks with 100 percent foreign capital and 946 non-bank financial institutions. By 2012, total assets of banking institutions were estimated at 5,085

trillion VND and equivalent to 172.36% of Vietnam's GDP (Hoang, 2013). Moreover, as stated by O'Connor (2000), these banking institutions prove their importance in the mobilization and allocation of capital in Vietnamese economy by accounting for 85-90 per cent of national financial intermediation. Nevertheless, for this channel being hindered or distorted, the economy might as well experience stagnation in economic growth.

Types	2012	2013	6/2014
State-owned commercial banks	43.29	43.51	44.71
Joint-stock commercial banks	42.46	42.80	41.91
Foreign banks	10.92	12.25	12.02
Financial institutions	3.33	1.44	1.36

Table 4: Percentage of banks' total assets compared to the whole banking system (Adapted from SBV's annual report 2012, and SBV's statistics)

As represented in the table, the total assets of state-owned commercial banks had increased significantly due to notable increment in charter capital. This trend is explained as counter-measures for banks against bad debts and as means of creditability. According to individual commercial banks' reports, total assets of Vietinbank, BIDV and Vietcombank are 579, 579 and 504 trillion VND respectively as in June 2014, while the total 5,962 trillion VND (SBV's statistics). Therefore, the state-owned banks still prove its importance as a capital channel between the government and enterprises.

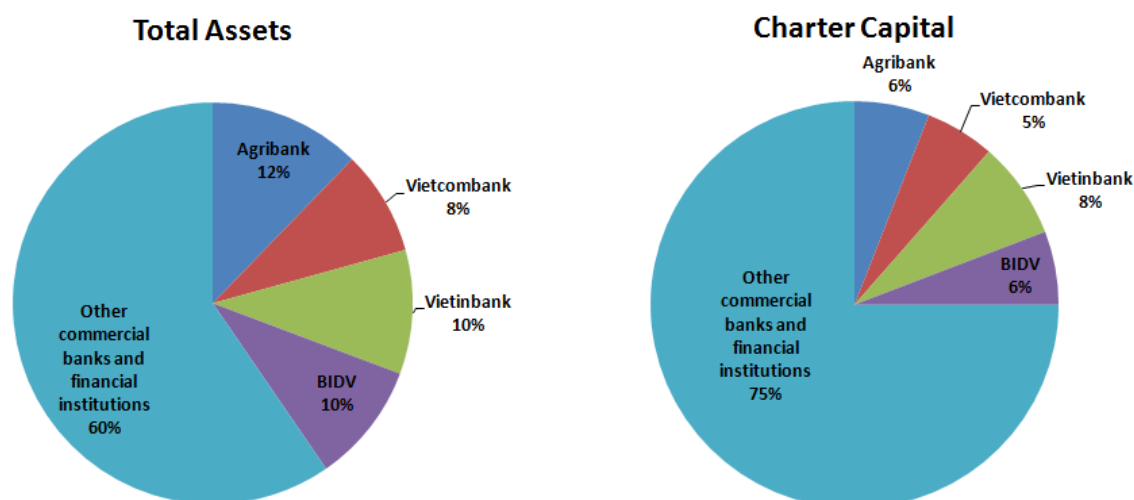


Figure 3: Shares of four state-owned commercial banks in total assets and charter capital June 2014 (Tung, 2014)

## 3.2 Current issues

In this subchapter, NPLs causes and their consequences are analyzed in accordance with the current context. The following discussion focuses on NPLs' presence in various aspects of Vietnamese economy.

### 3.2.1 Causes and consequences of bad debts in Vietnam

There are several factors contributed to the increase of NPL in banking sector. The subchapter will provide main causes of NPL, from both credit institutions' and enterprises' perspectives.

#### 3.2.1.1 From credit institutions' perspective

##### 1. Open monetary policy

Banking credit is the primary source of funding for the national economic development; however, instead of promoting corporate finance and production activities, an ample amount of this credit is poured into real estate market. In 2013, despite a decline in housing nonperforming loans, those still accounted for 80 percent of total nonperforming loans in the economy (Tran, 2014). As the market becomes stagnant, credit quality is as well decelerated, prompting an increase in inflation rate. Consequently, increment in production costs raises the commodity's price, contributing in the reduction of demand. When this happens, unsold goods accelerate while the enterprises are obligated to remunerate various types of costs. As for enterprises, insolvent firms may need to file for bankruptcy. As for credit institutions, loans granted may become unrecoverable and generate loss for creditors.

##### 2. Inadequate management capabilities

In Vietnam, there are actual cases of credit institutions which use short-term funds to mobilize medium and long term loans, producing a large degree of mismatch between the maturity of assets and liabilities. Consequently, poor liquidity and credit risk incur.

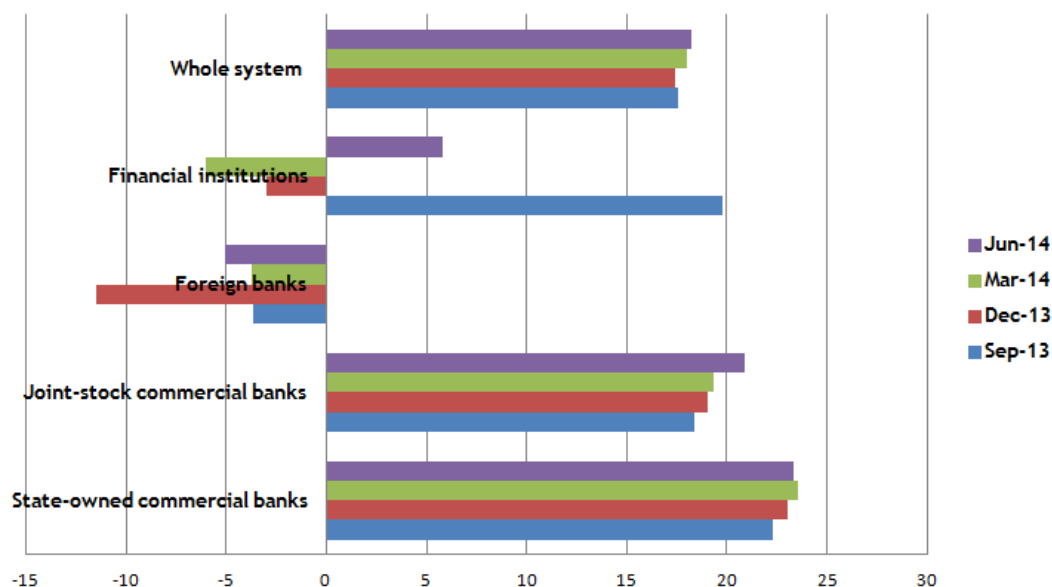


Figure 4: The percentage of short-term funds in medium- and long-term loans (Adapted from the SBV's statistics)

As illustrated in the above figure, not only do credit institutions grant funds for wrong purpose, the percentage of this misdeed is presented in almost all financial intermediaries, except for foreign-capital banks. The implication is that current governance system should be adjusted and amended accordingly, as well as the internal banking system.

Moreover, credit institutions tend to compete in the amount of total assets, thus implying an increase in interest rate to attract deposits. As a result, interest rates for debtors also increase, creating a "liquidity trap" in which borrowers gradually lose the reimbursement capabilities and commercial banks incur losses as bad debts (Pham, n.d.).

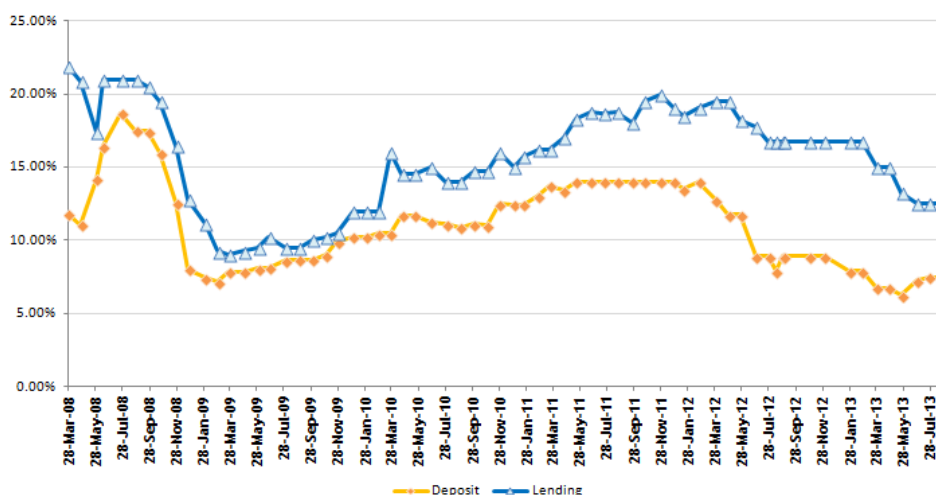




Figure 5: Interest rates of deposit and lending from 2008-2011 (Nguyen, 2013)

The interest rates fluctuated remarkably from 2008 to 2013, noticeably, a sharp increase for both indexes from March to July 2008. The highest recorded rates were 18.67 percent and 21.85 percent for deposit and lending respectively. Afterwards, even two indexes still varied, deposit rate was kept from 7.86 percent to 14 percent. From March 2012 onwards, the index started to decrease, recorded as 7.5 percent in August 2012. Lending rate fluctuated from lowest 9 percent to highest 19.5 percent. From December 2011, the index gradually decreased, reaching 12.5 percent in August 2012. Even though the indexes had declined, they were still high in comparison with current context of Vietnamese economy.

### 3. Pressure to extend credit for state-owned enterprises

This pressure is mainly applied for government-owned commercial banks. Therefore, those enterprises can easily gain access to bank credit, yet using the funds in non-expertise fields (such as banking, securities, real estate market, and so on) or in different sectors as defined in contracts. As there is limited experience, the entities are not capable of handling negative outcomes when the real estate freezes, or the securities and banking businesses are loss-making. Thus, insolvent loans become nonperforming for related credit institutions (Pham, n.d.).

### 4. Cross-ownership in banking system

Beside the core activities of raising capital and lending, credit institutions also implement investment plans. Due to cross-ownership, banks may grant the funds to affiliates for investment in housing, securities markets or purchase of other banks' shares. Inappropriate cross-ownership will generate a considerable amount of risks, exemplified as deterioration of credit quality, thus leading to a decline of current loans.

### 5. Moral hazards and incapability of credit officials

Moral hazards, expertise and capabilities of credit official may not be appropriate for the current banking industry. Process of appraisal, loan approval and monitoring is time-consuming and lack of efficiency.

Moreover, internal standards for loan classification differ from one bank to another, despite the fact that both approaches, quantitative and qualitative, should be applied

under the SBV's Decision 493/2005/QĐ-NHNN. According to Vietcombank Securities, there were only three banks including Agribank, BIDV and Vietcombank, which implemented both approaches until June 2012. Three rationales were offered as explanation. The first one was that internal credit rating system must be built to apply the classification method. The second reason provided was that qualitative method would increase NPL ratio twice or thrice in comparison with quantitative method. The last rationale was qualitative method also had various shortcomings (My, 2012). In addition, as NPLs are yet to be classified based on their actual probabilities of recovery, provisions secured for those may not be enough to cover if they are default.

According to Ms. X, credit officer at LienVietPostBank, and Mr. T, credit officer at Vietinbank, moral hazards and incapability of credit officials have paramount contributions to impairment loans. Interview answers show that appraisal approach and loan monitoring are not sufficiently implemented; there were cases of lending due to previous engagement, or adjusting collaterals' value for granting more funds.

#### 6. Problems in collateral resolution mechanism

In many cases, properties are often use as collateral. When the loan is default, it is legal for institution to sell the collateral. However, according to current regulations, it is impossible to name the properties without owners' approval. If brought to courts, the processing time is long, as well as complex procedures and maintaining costs; hence, the market value of such property will not be the same as stated in the binding terms. Under circumstances that such property is sold, credit institution will still bear the loss.

According to Mr. T, credit officer at Vietinbank, various cases of inefficient pledge resolution are recorded. He also mentions that expenses are usually greater than the actual compensation from selling those collaterals.

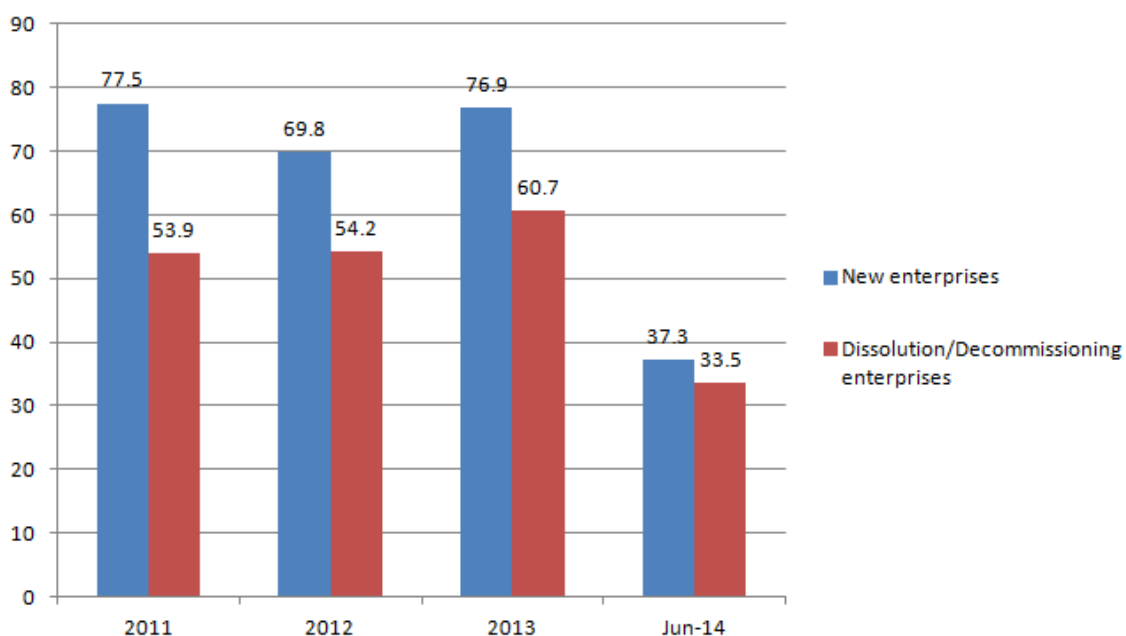
#### 3.2.1.2 From enterprises' perspective

##### 1. Frozen real estate market and loss-making businesses

In 2008, bubble in housing market became worse, accompanied by growing inflation rate. As market stability and inflation countermeasures, the government had implemented restriction on credit-granting policies, especially on non-production loans. Shortly after those tightening policies, performance of the market was severely affected, showing in a decline of both prices and transactions. Enterprises involved in

the field were also in difficult position dealing with the situation when policies on land taxes were amended in 2010.

However, the scenario was similar for other sectors. In 2011, as Vietnamese macro-economy was instable, loans for non-production claims were restricted to 16 percent of total outstanding loans. The market showed no sign of recovery in the same year (Phuong Nam securities, n.d.); moreover, inflation rate was rather high during the time. In 2012, the first time in last 10 years did the country witness an ample of enterprises going bankruptcy. According to Vietnam Chamber of Commerce and Industry, there were 54,261 dissolution entities in a total of 475,700 active ones (Xuan, 2013).



(Amount in thousand enterprises)

Figure 6: Newly-established and dissolution or decommissioning enterprises of all sectors recorded in 2011-June 2014 (Adapted from National Business Registration Portal and SBV's report)

As illustrated in the figure, the number of dissolution or decommissioning enterprises has showed no sign of improvement, reservedly, a median of 6,800 inactive enterprises was recorded from 2011 until 2013. In June 2014, the recorded numbers of inactive enterprises accumulate for more than half of those in previous years. Noticeably, the difference between active and inactive enterprises in the same year is just 3,800 enterprises.

An example of loss-making business can be Vinashin, a state-backed shipbuilding enterprise. From 2005 to 2010, accumulation of its outstanding loans was 86,700 billion VND, approximately 4.4 billion USD (Bloomberg, 2010) and annual interest of 10,000 billion VND. During the course of time, the corporation did not have an efficient investment plan, using the granted funds for purposes not in compliance with contractual terms. Consequently, many cases of lost capital incur, causing the enterprise to be default. Taking account of international bonds of 750 million USD had issue for Vinashin, it is likely that the state budget has to cover 1.35 billion USD debt burden for the enterprise (Ly, 2013).

For credit institutions which engaged in Vinashin's granted funds, Habubank and PetroVietnam Finance Corporation (PVFC) were severely affected. Habubank underwent merger process with SHB due to 3,345 billion VND debt burden of Vinashin. As to PVFC's merger plan with Western Bank, the bank had to ask for the government's permission in excluding 2,800 billion VND worth of debt in the NPL rate of consolidated bank (Nguyen, 2013).

## 2. Inappropriate interest rate

In the current context, dilemma in supply-demand relationship does exist: Interest rates are still too high, beyond the enterprises' capabilities. Even though there is a need, enterprises still hesitate to borrow credit supply from financial intermediaries. Furthermore, assuming that interest rates would be reduced to as low as 10 percent; yet, interest rates of previous loans would still be the same. Those with credit shortage cannot reimburse the old ones; let alone filling for a new claim. As a result, those enterprises may need to decommission their business, or as worst scenario, file for bankruptcy.

### 3.2.2 Bad debts situation in Vietnam

In the context of current economic downturn, the issue of loan resolution in banking sector is the most concerned matter. Those NPLs are the fundamental cause of economic stagnant, insecurity in national banking system; as well as reflecting increasingly difficult situation of enterprises. It can be seen in the following figure that reported NPL rate has continued to soar since 2009 and was recorded as 4.17% of total outstanding loans in June 2014.

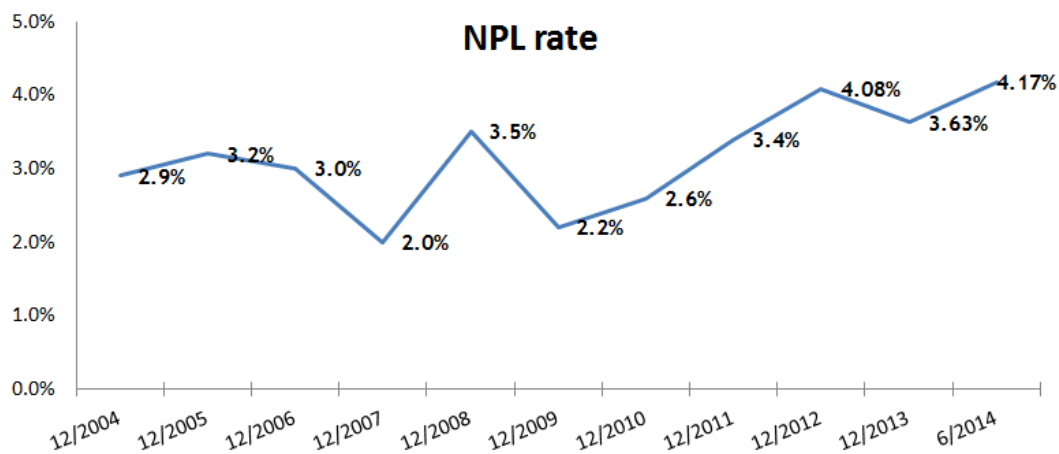
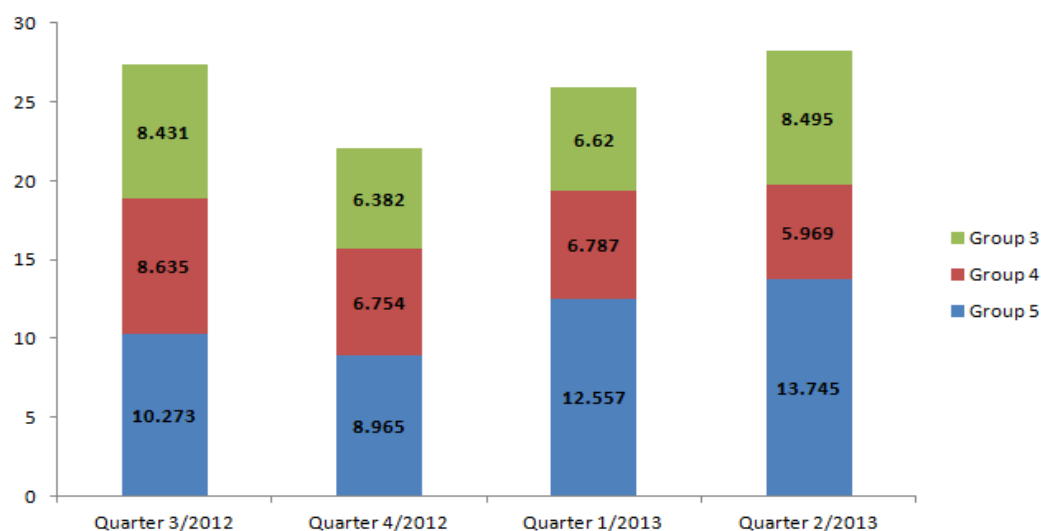


Figure 7: Nonperforming Loan Rate across banking sector (Adapted from SBV's statistics)

Moreover, the structure of NPLs in banking institutions is presented in the following figure, where nonperforming loans were largely composed of Group 5 (Loss), accounted for nearly one third of total NPLs. Thus, commercial banks had to reserved more provisions out of total capital raised, instead of using those funds for enterprises with financial shortage.



(Amount in trillion VND, classification under Decision 780/QD-NHNN)

Figure 8: Structure of NPLs in commercial banks (Hoang, 2014)

In particular, NPL rates of a number of commercial banks are noticeable, especially Agribank's - a state-owned bank. For three consecutive years, its NPL ratios were not lower than 6 percent, which is twice the Vietnamese safety index of 3%. Moreover, in June 2014, the ratios among credit institutions are still higher than those of previous years, despite the enforcement of policies to control the index. The same applies with three other government-backed commercial banks including Vietcombank, Vietinbank and BIDV.

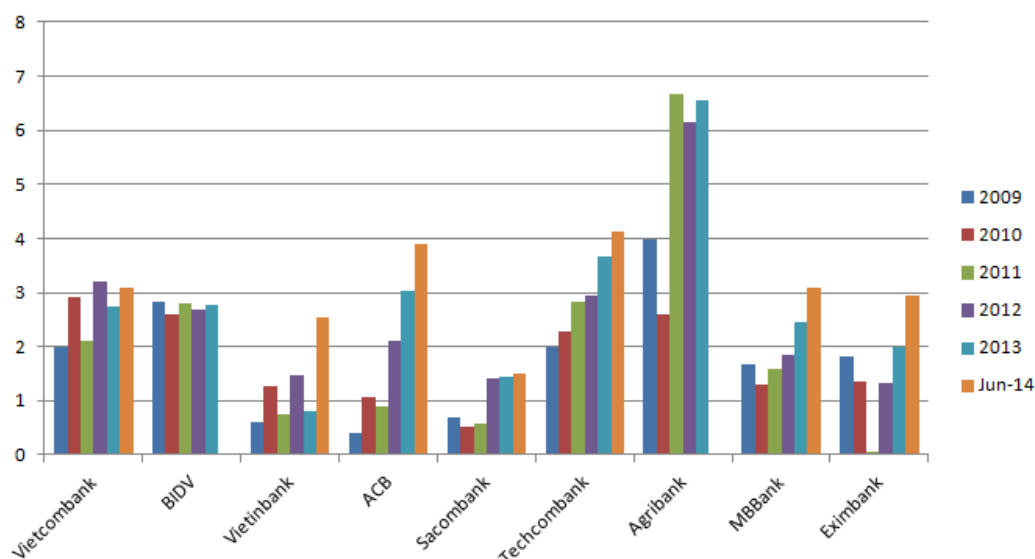


Figure 9: NPL rate among commercial banks (in percent)

Note:

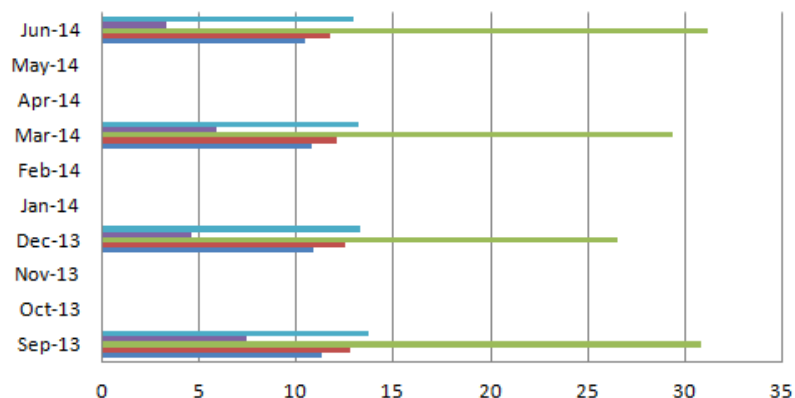
- No official disclosure from BIDV and Agribank for 2013, 6/2014. Statistics based on Quarter 3/2013;
- All other banks' NPL rates are estimated based on respective individual reports;

Also, in 2014, the NPL ratios have increased in comparison of 2013. According to Ms. Hong, Vice governor of the SBV, there are two main reasons. Firstly, economic conditions have yet to improve, and enterprises encounter financial shortage; therefore, an ample amount of loans are still unrecoverable. Secondly, under new SBV's Circular 09/2014/TT-NHNN, loan categories and provisions also apply for investment on corporate bonds, which were not included in previous policies (Phuong, 2014).

However, there are also so positive highlights, thus implying the economy has been gradually recovering.

Firstly, banking operations has shown signs of improved creditability and efficiency. For instance, credit risks in current situation are controllable to some extent. One measure for evaluation is to use Capital Adequacy Ratio (CAR), also known as Capital to Risk (Weighted) Assets Ratio. In Vietnam, the safety index is above 9 percent (SBV's Circular 13/2010/TT-NHNN, 2010). The ratio is calculated on the basis of total capital over risk weight asset. The current situation in Vietnam's financial sector is expressed as followed:

### Capital Adequacy Ratio



	Sep-13	Dec-13	Mar-14	Jun-14
Whole financial system	13.76	13.25	13.24	12.94
Financial institutions	7.43	4.63	5.88	3.35
Foreign banks	30.82	26.53	29.36	31.12
Joint-stock commercial banks	12.81	12.56	12.12	11.77
State-owned commercial banks	11.31	10.91	10.84	10.44

Figure 10: Capital Adequacy Ratio among credit institutions (Adapted from SBV's statistics)

Except for non-bank financial institutions, all commercial and foreign banks achieve rather high ratios for CAR. Even though there was slight decrease in the whole financial system, the index is still far beyond the predefined index by the government.

To assess the liquidity risks financial institutions may encounter, the researcher will use Loan-to-Deposit ratio (LDR) as an indicator. The ratio is calculated by dividing total loans with total deposits. According to International Monetary Fund (2013), the higher the ratio is, the more distressed credit institutions may encounter where liquidity difficulties arise.

### Loan-to-Deposit Ratio

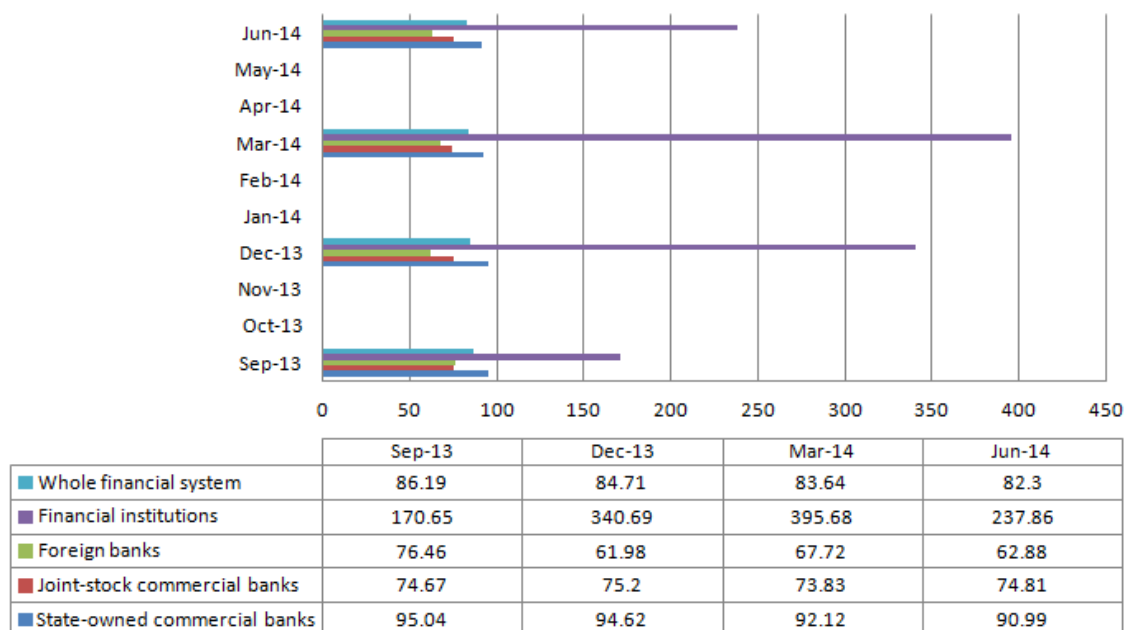
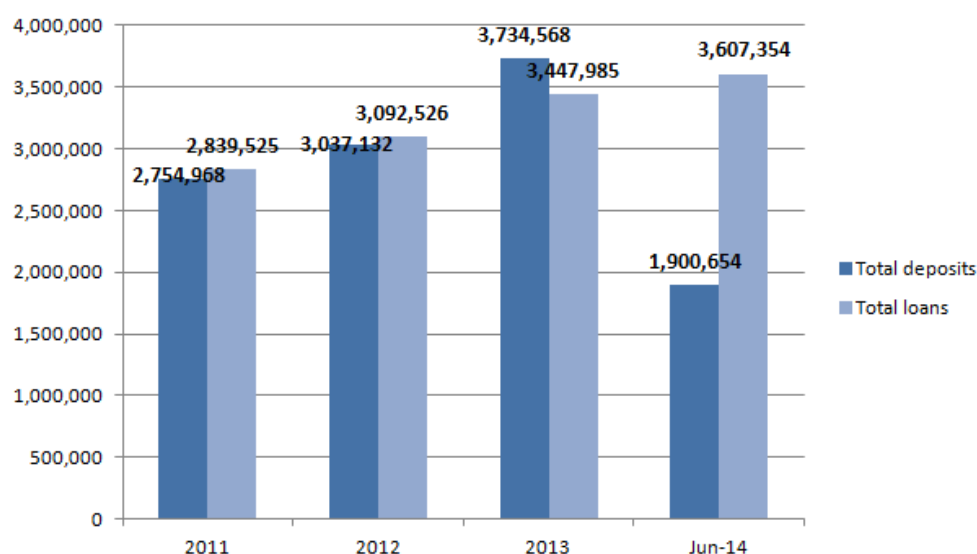


Figure 11: Loan-to-Deposit Ratio among financial institutions (Adapted from SBV's statistics)

Except for other financial institutions, both commercial and foreign banks have relatively lower LDR, ranging from over 70 to 95 percent. As there is no defined restriction under present policies, and if compared to 95 to 105 percent typically found in healthy banks (Farrell and Nelson, 2008), credit institutions are rather safe from liquidity risks.

Moreover, increment in total deposits and total claims is also recognized. Certainly, it does not mean the economy has fully recovered, yet that is still a positive signal for the government in the current approach to bad debt resolution.





(Amount in billion VND)

Figure 12: Total deposits and claims from 2011 to June 2014 (Adapted from SBV's annual report 2012 and SBV's statistics)

### 3.3 Bad debt and provisions for bad debt in Vietnam

#### 3.3.1 Classifications of debts

Categorization of loans has been adjusted various times to effectively reflect the status of Vietnamese economy. In this discussion, the most current categorization is presented. According to the State Bank of Vietnam (SBV), under SBV' Circular 02/2013/TT-NHNN and later adjusted by Circular 09/2014/TT-NHNN, there are five classes of debts as followed:

##### **Group 1:** Standard debts

- 1.1. Debts that are yet to overdue;
- 1.2. Or overdue below 10 days and financial institutions assess that debts will be recovered both principals and interests by the latest day of loan tenor;
- 1.3. Restructured loans under Paragraph 2;

##### **Group 2:** Watched debts

- 2.1. Debts which are overdue for a period of less than 90 days;
- 2.2. Debts with first repayment term being adjusted;
- 2.3. Restructured loans under Paragraph 2 and 3;

##### **Group 3:** Sub-standard debts

- 3.1. Debts which are overdue for a period of 90 to 180 days;
- 3.2. Debts with extended loan tenor for the first time;
- 3.3. Debts with no or reduced interests rate if borrowers cannot afford to pay in full;
- 3.4. Or in one of the following conditions:
  - Debts belong to entities/entities' guarantors who are not allowed to receive credit in accordance with law;
  - Debts secured by the shares of the credit-granting institution or subsidiary of that credit institution; or loans used to raise capital for another financial institution and the credit-granting bank receive shares of the loan-receiving institution as collateral;
  - Unsecured debts, or debts granted with preferential terms; or the loans' value exceed 5 percent of the bank's equity and are granted to borrowers subjected to credit limit prescribed by law;
  - Debts issued to subsidiaries, or associated companies of the credit institutions

or enterprises in which the credit institution possesses shares' value exceeds the limit in accordance with law;

- Debts exceeded the value of the credit limit, except being permitted by law;
- Debts violating the provisions of law on granting credit, foreign exchange management and capital adequacy ratios of credit institution;
- Debts violating financial institutions' internal legislations on granting credit, loan management and risk reserves;

3.5. Assets being recovered under inspection's result;

3.6. Asset recovery being conducted in less than 30 days after inspection's result;

3.7. Restructured loans under Paragraph 2 and 3; and Paragraph 11 of Article 9;

**Group 4:** Doubtful debts

4.1. Debts which are overdue for a period of 181 to 360 days;

4.2. Restructured debts, with first repayment term being adjusted, overdue less than 90 days in accordance with restructured repayment term;

4.3. Debts with extended loan tenor for the second time;

4.4. Assets recovery under provision of 3.4 being conducted for a period of 30 to 60 days after inspection's result;

4.5. Assets recovery under inspection's result yet to complete in 60 days;

4.6. Restructured loans under Paragraph 2 and 3; and Paragraph 11 of Article 9;

**Group 5:** Loss

5.1. Debts which are overdue over 360 days;

5.2. Restructured debts, with a first time repayment period being adjusted, overdue more than 90 days in accordance with restructured repayment term;

5.3. Restructured debts, with a second time repayment term being adjusted, overdue in accordance with new repayment period;

5.4. Restructured debts, with a third time repayment term being adjusted, overdue or yet to overdue;

5.5. Assets recovery under provision of 3.4 being conducted for more than 60 days after inspection's result;

5.6. Assets recovery under inspection's result yet to complete more than 60 days;

5.7. Debts of credit institutions which are being placed under special monitoring by the SBV; or of institutions whose capital and assets are frozen;

5.8. Restructured loans under Paragraph 3 and Paragraph 11 of Article 9;

Classification of loans is also implemented in accordance with Paragraph 2, 3 of Article 10 and Paragraph 11 of Article 11 stated in the Circulars. Depending on those provisions, loans can be categorized in the same, more or less risky group.

Bad debts (or NPLs) are debts, which are categorized as Group 3, 4 and 5 under such classification. The two Circulars are in effective since March 2014. Previously, banking institutions in Vietnam followed the instructions in Decision 493/2005/QD-NHNN, which was adjusted by Decision 780/2012/QD-NHNN. The comparison can be seen in the following table:

Classification	Criteria (02/2013/TT-NHNN and 09/2014/TT-NHNN)	Criteria (493/2005/QD-NHNN)
<u>Group 1: Standard</u>	Current or overdue debts below 10 days;	Current debts; Or restructured debts with repayment term adjusted, principal and interests paid in full during restructured repayment term;
<u>Group 2: Watch</u>	Overdue debts below 90 days; Or debts with repayment term adjusted for the first time;	Overdue debts below 90 days; Or current debts under restructured repayment term;
<u>Group 3: Sub-standard</u>	Overdue debts between 90 to 180 days; Or debts with loan tenor being extended; Or loans not in accordance with present law; Or recovery yet to complete in less than 30 days after inspection' result;	Overdue debts between 90 to 180 days; Or restructured debts overdue less than 90 days;
<u>Group 4: Doubtful</u>	Overdue debts between 181 to 360 days; Or restructured debts overdue less than 90 days; Or debts with loan tenor extended for a second time; Or loans not in accordance with present law yet to recover between 30 to 60 days; Or recovery yet to complete in less than 60 days after in-	Overdue debts between 181 to 360 days; Or restructured debts overdue between 90-180 days;

	inspection' result;	
<u>Group 5: Loss</u>	Overdue debts over 360 days; Or restructured debts overdue less than 90 days; Or debts restructured for more than two times; Or loans not in accordance with present law yet to recover more than 60 days; Or recovery yet to complete in more than 60 days after inspection' result;	Overdue debts over 360 days; Or restructured debts overdue more than 180 days; Or frozen debts pending settlement by the government;

Table 5: Classification of debts (Adaptive from Circular 02/2013/TT-NHNN, Circular 09/2014/TT-NHNN and Decision 493/2005/QD-NHNN)

Under the latest Circular, Articles concerning the scope of asset classification, collateral appraisal, usage of credit information, loan classification, and asset quality of banks are stricter than those in former Decision; however, NPLs situation will be truly reflected and Vietnam is getting closer to the international standards Basel II in debt classification. The government expects to have meaningful NPL ratios in the upcoming financial institutions' reports by the enforcement. The figures may become worse, yet on the bright side, a real picture can be seen and the government will know how to proceed with loan resolutions.

### 3.3.2 Provisions for bad debts

Under Circular 02/2013/TT-NHNN and Circular 09/2014/TT-NHNN, banking institutions are required to set up two types of provisions: general provision and specific provision. Firstly, the amount of general provisions is equal to 0.75% of the total value of debts from Group 1 to Group 4 classified as above.

Secondly, on the basis of loan classification, a specific provision is calculated as followed:

Class	Ratio of specific provisioning
<u>Group 1: Standard</u>	0%
<u>Group 2: Watch</u>	5%
<u>Group 3: Substandard</u>	20%
<u>Group 4: Doubtful</u>	50%
<u>Group 5: Loss</u>	100%

Table 6: Ratios of specific provisioning (Adapted from SBV's Circular 02/2013/TT-NHNN)

As stated in Circular 02/2013/TT-NHNN and Circular 09/2014/TT-NHNN, the amount of specific allowance for individual debt is calculated by the following formula:

$$R = \sum_{i=1}^n Ri$$

In which,

R: The total amount of specific provision to be reserved for individual borrower;

$$\sum_{i=1}^n Ri$$

: The total amount of specific provision to be reserved of individual borrower from the first to the n<sup>th</sup> outstanding loan;

Ri: The amount of specific provision for individual borrower for the principal of i<sup>th</sup> outstanding loan. Ri is calculated by the formula:

$$Ri = (Ai - Ci) * r$$

In which,

Ai: Principal balance of i<sup>th</sup> outstanding loan;

Ci: Value of security assets of i<sup>th</sup> outstanding loan;

r: Ratio of specific provisioning for individual group;

### 3.4 Countermeasures implemented by the government

#### 3.4.1 Approach' objectives and the State Bank of Vietnam's proposals

According to Nguyen (2012), to prevent worse credit environment, the SBV had implemented policies in favor for both enterprises and banking institutions. Two main objectives of those approaches are:

- Promoting credit access for business through loan tenor adjustment, debt rescheduling and yet remaining in the same loan class; therefore, enterprises can receive loans to continue the business;
- Reducing interest rates for both deposit and lending so that enterprises can operate with less costs;

Besides, the SBV also proposed some courses for debt disposition, alongside with the official establishment of Vietnam Asset Management Company (VAMC):

- Credit institutions need to comply with latest regulations on lending, capital adequacy ratio and granted credit limits, no new loans should be granted to reimburse old one for the purpose of hiding NPL ratio;
- Financial entities should cooperate with borrowers to perform quality evaluation and estimate probability of debt recovery, thus making appropriate remedies such as debt restructuring, sufficient provisions in accordance with latest regulations, or performing procedure for loan recovery;
- Credit institutions may reduce redundant costs, and support enterprises in means of lower interest rate for priority sectors and production-related business;
- Loan classification, provisioning and use of provisions should be reviewed and amended to stay applicable in practical conditions of Vietnam, as well as getting closer to the international standards. Moreover, modification and amendment will be made to prevent liquidity and credit risks in banking operations;
- Efficient and comprehensive supervisions from the SBV's representatives will ensure the affirmation of credit institutions in their compliance with granting credit limit, loan categorization, risk provisioning and regulations on credit safety;

However, to thoroughly resolve NPLs in Vietnam, countermeasures for all entities involved, meaning the government, credit institutions and enterprises, must be conducted. Notwithstanding, a stable macroeconomic environment will give confidence for investors and entrepreneurs in doing business in Vietnam.

#### 3.4.2 Vietnam Asset Management Company (VAMC)

On June 26 2013, Vietnam Asset Management Company or AMC was officially established. Under SBV's Decision 1459/QĐ-NHNN, the AMC is the government's special means for fast impaired loans resolution, reducing financial risk for credit institutions, enterprises and promoting reasonable credit growth in the economy.

VAMC is a specialized state-owned agency subject to the management, inspection and direct supervision of the SBV. The AMC operates with initial charter capital of 500,000,000,000 (five hundred billion) VND and by the principle of non-profit orientation; publicity and transparency; minimization of risk and NPLs' expenditure. Its mandate is rapid asset disposition and debt restructuring.

The agency official bought bad debts from banking sector from October 1 until December 31 2013, having purchased approximately 39 trillion VND of total outstanding loans as well exceeding the target of 35 trillion VND worth (VAMC, n.d.). In August 2014, VAMC has acquired a total of 58,937 billion VND worth of NPLs, from 35 credit institutions with 3,356 claims and the purchase price is 48,976 billion VND (Duyen, 2014).

According to President of VAMC Mr. Hung, not only does the AMC aim at asset disposition, the agency also analyzes the possibility of supporting borrowers. Those with high recovery possibility will receive preferential interest rate, or enterprises with prospective business plan will be able to receive loans. With prospective borrowers, VAMC will consider being their loans' guarantor; investment in forms of loans or purchase of enterprises' bonds; or using acquired bad debts to raise capital. As for those with no possibility of recovery, VAMC will collaborate with credit institutions for the sale of collaterals. Yet, as asset markets and securities market in Vietnam are still developing, debt resolution is still progressing at a rather slow pace (Duyen, 2014).

	Vietnam's AMC
Name of AMC	Vietnam Asset Management Company
Year of Establishment	2013
Legal basis	Instituted by SBV's Decision 1459/QĐ-NHNN in June 27, 2012
Official mandate	Restructuring/rapid disposition (focus on debt restructuring)
Corporate restructuring	VAMC
Legal basis	Government-owned agency
Governance and supervision	Representatives from the SBV and banking institutions
Funding	VAMC's government guaranteed bonds, government funding
Disclosure	No official report by VAMC has been established
Legal powers for asset resolution	Yes
Sunset date	N/A
Scope of asset transfers	Nonperforming loans
	Banking institutions
Asset transfer pricing	Fair value
Incentives	Gain- or loss-sharing
Statutory requirements for transferred assets	Collaborating with credit institutions
Asset securitization	N/A

Table 7: Summary of VAMC (Adapted from SBV’s Decision 1459/QĐ-NHNN and Circular 19/2013/TT-NHNN)

Since VAMC has only been in operation for more than six months, no remarkable change in credit growth or NPL ratios is noticeable. However, as to whether the agency is a comprehensive method of Vietnam’s loan settlement, further observation must be conducted.

	Year of AMC’s establishment	GDP growth (in percent)			Credit growth (in percent)		
		One year prior	Year of establishment	One year after	One year prior	Year of establishment	One year after
Vietnam	2013	5.25	5.42	5.18*	8.91	12.51	3.52**

Table 8: GDP and credit growth (General Statistics Office, 2014; Kinh, 2014; Hong, 2014)

Note:

- \*GDP growth recorded in column “One year after” is that of mid 2014;
- \*\*Credit growth recorded in column “One year after” is that of mid 2014;

#### 4 Case studies

##### 4.1 Korea - Korea Asset Management Corporation (KAMCO)

Impressive economic growth during the period from 1980 to early 1990s led to excessive investments without thorough analysis of benefits and risks. Besides, foreign banks operated in Korea borrowed short-term loans in foreign currency to finance long-term loans in local currency. These activities eventually weakened the banking system. This was also the primary factor that led to financial crisis in Asia in 1990s.

According to He (2004), NPLs of the entire financial system in 1998 accounted for 118 trillion Korean won, approximately 18 percent of total loans and 27 percent of GDP, in which 42 percent was debts overdue from three to six months and remaining 58 percent was loans overdue more than six months. Under such circumstance, Korean government took these listing actions:

Firstly, Korea Asset Management Corporation (KAMCO) was established as an agency to purchase NPLs from distressed banks. KAMCO was funded by Ministry of Finance and Economy (MOFE) (42.8 percent), Korea Development Bank (KDB) (28.6 percent) and other financial institutions. The agency was strictly governed by Management Supervisory Committee, including Managing Director of KAMCO, representatives from the MOFE, the Ministry of Planning and Budgeting, the Financial Supervisory Commission, and the Korea Deposit Insurance Corpora-



tion; the Deputy Governor of the KDB; two representatives from the banking industry nominated by the Chairman of the Korea Federation of Banks; and three independent professionals including an attorney-at-law, a CPA or a certified tax accountant, and a university professor or a doctorate holder who belongs to a research institute (He, 2004).

It is vital to establish a pre-determined and achievable sunset date due to two main reasons. Basically, a well-defined sunset date may help accelerate the AMC's process in NPLs resolution and enable the AMC to have an ample of time to attain its mandate. Secondly, with specific timeframe, the public has a means to evaluate the AMC's efficiency in attending bad debts. For KAMCO, there was no sunset date partly due to its objective in corporate restructuring (Fung et al., 2004)

KAMCO classified loans into Ordinary NPLs and Special NPLs. Ordinary PNLs included those with low probability of reimbursement from debtors. Special NPLs indicated ones from restructuring companies; hence, those loans were restructured with lower interest rate and longer repayment period. Special NPLs were also categorized into secured and unsecured loans. After acquisition, purchased impairment loans would be sold for investors through international auctions or issued as asset-backed securities, and the remaining loans would be restructured by KAMCO. The volume of NPLs purchased by the agency increased over the year. The ratio of remaining NPLs over total NPLs significantly declined, from 88.6 percent in 1997 to 24 percent in 2001, implying the positive role of KAMCO in the acquisition and disposal of bad debts. In 2001, the process of debt settlement in South Korea was almost completed (Ha, 2014).

Secondly, other law enforcement agency was established to facilitate the process of financial and corporate sectors' restructuring, known as corporate restructuring company (CRC). This agency specialized in corporate restructuring and acted as Treasury bond agency. Its mission was to revive those enterprises with limited probability of reimbursement. Therefore, CRC would purchase their shares and/or their impairment loans from KAMCO and Korea Deposit Insurance Corporation (KDIC).

Thirdly, several supporting measures were implemented. Government offered preferential policies on tariff for those entities operating in NPL market. Commercial banks were also required to set up more loan loss provisions for impairment loans and tighter discipline on loan classification. Besides, to encourage the sale of bad assets, Korean government enacted following special tax law (Ha, 2014):

- Reduced tax on capital surplus: Tax on surplus derived from conversion of impairment assets owned by financial institutions such as KAMCO would be reduced 50 percent.
- Deductibility: When commercial banks possessed more bad debts over their loan loss

provisions, banks were allowed to use provisions for asset revaluation to finance the premium. That premium would be charged as expenses when calculating the taxable income of banks.

- Tax exemption for stock exchange: When KAMCO, KDIC or any financial institutions purchased shares from those enterprises, which lost the ability of reimbursement, for restructuring and converted those shares to a third party, profits and expenses would be exempt from tax.

#### 4.2 Malaysia - Pengurusan Danaharta Nasional Berhad (Danaharta)

Since The 1997 Asian Financial Crisis, Malaysia also experienced substantial increase in NPLs, which endangered the whole regional banking system. Therefore, in June 1998, the Pengurusan Danaharta Nasional Berhad (or Danaharta) as an asset management company was established. Its mandate is to remove impairment loans from financial institutions' balance sheet at a reasonable price and maximize the recovery value of those, thus smoothing other financial intermediation of those banks. Mentioned in previous research of Fung et al. (2004), Danaharta was set to halt in 2005.

First approach by Danaharta was to purchase impairment loans from the banking sector. As at March 2001, Danaharta had successfully obtained NPLs amounting to 38.2 billion Ringgit Malaysia (RM) or 42 percent of total NPLs in the banking sector. Due to strong pressure from government, the purchase of nonperforming assets was made only within six months with financial institutions selling assets at average discount of 46 percent to their gross value. (United Nations, 2001)

Secondly, Danaharta' focus was not on foreclosure or the sale of assets but to proactively restructure loans and eventually maximize recovery value of collaterals. As in United Nations (2002), during 1998-2005 Danaharta had recovered 23.1 billion RM worth of outstanding loans an achieved an average recovery rate of 60 percent. Danaharta also formed a transparent mechanism for assets' administration under the supervision of MOFE representatives; three members from The Central Bank of Malaysia (Bank Negara Malaysia). Danaharta also had an oversight committee comprising three independent members for special administration and advisories. For corporate restructuring, Malaysian government established a separate corporate restructuring agency (CDRC) (Fung et al. 2004)

The Government also established Danamodal as special government-owned agency to recapitalize weak but viable financial institutions. According to United Nations (2001), since 1998 Danamodal had injected 7.1 billion RM into 10 financial institutions and improved the average risk-weighted capital ratio (RWCR) to 13.9 percent in May 1999. In 2000, as economic condi-

tions showed signs of improvement along side with merger program for local banks, eight banks had reimbursed their loans to Danamodal, thus increasing the total amount of capital injection to 3.7 billion RM in March 2001.

In tandem with capital injection, bank shareholders approved the reduction of their shares in banking institutions, changed the board of management. Danamodal appointed representatives to monitor carefully their management discipline and conduct necessary changes.

Moreover, Malaysian government also announced merger plans to consolidate 58 financial institutions into 6 groups. This program was supported by the Bank Negara Malaysia and was in compliance with WTO regulations in the financial sector.

In addition to those approaches, Malaysia developed the national bond market to prevent overflowed amount of bad debts in financial market. Bond market development was a priority since it was an alternative channel to raise capital along side with other financial intermediation activities; and defective bond market was a major reason for impairment loans in Malaysia in 1997. Therefore, the government implemented several policies including (Phuwong, n. d.):

- By simplifying the registration process, enterprises could issue bonds under acceptable level of risks or ones with long maturity period for individual investors.
- Focus on developing repo market (in other words, repurchase agreement market in which the importance of short-term capital raised is emphasized) and expanding customer's types.
- A long-term plan to develop a vibrant bond market with ample issuers, investors and financial institutions.
- Insurance for bond markets as a support for enterprises' credit portfolio.

#### 4.3 Conclusion

According to Woo (2000), for an effective design of AMCs, it is necessary to achieve the listing criteria

- Legal basis: Establishing a clear set of criteria for asset transfers' priorities, entitling the purchase and sale of collaterals without debtors' approval
- Regulatory framework: Consolidated supervision to remove banking institutions' falsified capital position
- Governance: Transparent, insulated from political interference and borrowers' pressure board of supervision
- Selection of asset transfers: Large or fixed collaterals, loans requiring foreclosure
- Asset transfer pricing: Based on probability of recovery, cash flow analysis and evalu-

ation of gross value

- Funding: Sufficient, separate budget for operation and purchasing collaterals
- Incentive structure: Profit/Loss sharing arrangements with banking institutions, bonuses for improved recovery rate or management of NPLs
- Asset disposition: Based on market conditions and costs of management
- Legal power: Power to facilitate corporate and debt restructuring process, loan resolution process
- Lending: Restricted to prevent any interference from banks and AMCs' engagement
- Tax issues: Favorable for both banking institutions and AMCs

And actual implementation of Korea's and Malaysia's AMCs:

	Korea's AMC	Malaysia's AMC
Name of AMC	Korea Asset Management Corporation (KAMCO)	Pengurusan Danaharta Nasional Berhad (Danaharta)
Year of Establishment	1962	1998
Legal basis	Instituted by law in 1962, role expanded in 1997	Incorporated under the Company Act of 1965
Official mandate	Restructuring/rapid disposition (focus on debt restructuring)	Restructuring/rapid disposition (focus on corporate restructuring)
Corporate restructuring	Mainly by KAMCO	CDRC
Legal basis	Subsidiary of KDB	Government-owned agency
External supervision	Financial Supervisory Service, Ministry of Finance and Economy	Ministry of Finance and Economy
Internal governance	Board of 11 members with no outside member	Board with outside members, an oversight and audit committee of three representatives
Funding	Financial institutions, KDB, KAMCO's government guaranteed bonds	Danaharta's zero-coupon government guaranteed bonds, government funding, Khazanah (Malaysia's investment fund)
Disclosure	Annual report, website regularly updated; audited by an international accounting	Annual report, semiannual report, operations report, website regularly updated,

	firm	regular press conferences; audited by an international accounting firm
Legal powers for asset resolution	Yes	
Sunset date	No	2005
Scope of asset transfers	Nonperforming loans	Nonperforming loans
	Banks and non-banks financial institutions	Banks, finance companies and merchant banks
Asset transfer pricing	Average discount of 36.1 percent	Average discount of 46 percent
Incentives	Gain/Loss sharing agreement	
Statutory requirements for transferred assets	Yes	
Asset securitization	Both international and domestic markets, 22 percent of total recovery	Domestic market only, 2 percent of total recovery

Table 9: Summary of KAMCO and Danaharta (Fung et al. 2004; Woo, 2000)

It can be seen that both AMC's had certain characteristics fitting the criteria proposed by Woo (2000). Besides, KAMCO and Danaharta were the only AMC's which achieved the recovery rate of 50-60 percent among other AMC's operated in Asia. As for Vietnam Asset Management Company (VAMC), which was established in 2013, those AMC models will be beneficial for referencing.

## 5 Conclusion and suggestions

Throughout the study, readers are expected to have more insights about the current issues in Vietnam. This chapter will provide a summary of the research by presenting answers to the research questions mentioned in the first chapter. The proposals for improving national situation are also presented. Brief answers for those research questions are presented as followed:

Research questions	Brief Answers
What is bad debt, its causes and consequences?	Bad debt is defined as an amount owed by a debtor that is unlikely to be paid. There are five principal elements that may trigger nonperforming loans: inevitable factors, poor transparency of information, inadequate management, economic environment, and

	legal environment. Concerning impaired loans' consequences, commercial banks may be adversely influenced in reputation, loan settlement difficulties, profitability, and probability of bankruptcy. For the economy, bad debt will increase constraints for foreign investors and hinder other economic activities.
How could the impairment loan be controlled in precedent cases?	There are two approaches for impaired loan settlement: centralization and decentralization methods. Centralization approach encourages the establishment of centralized government-owned asset settlement agency, while decentralization method suggests the introduction of various credit institutions' and private asset management agencies.
What has been done by Vietnam's government in asset resolution?	Various approaches have been made such as introducing guidelines for debt classification and establishment of Vietnam Asset Management Company.

Table 10: Short answers to research questions

As illustrated in Table 9, answers to designated research questions have been found during the investigation in Vietnamese economy. Firstly, bad debt's definition can be summarized as a sum of loan which is probable for loss due to debtor's liquidation. The study shows that there are five fundamental reasons, which are inevitable factors, poor transparency of information, inadequate management, economic environment, and legal environment. Impairment loans will directly affect commercial banks with reputation, loan settlement difficulties, profitability, and probability of bankruptcy. Meanwhile, for the economy, bad debt will increase constraints for foreign investors and hinder other economic activities.

Secondly, according to the research, there are fundamentally two approaches to resolve non-performing loans, which are centralization and decentralization. Centralization method supports the idea of having centralized government-owned asset settlement agency to settle impaired loans and encourage corporate restructuring. Decentralization approach suggests the introduction of various credit institutions' and private asset management agencies, each has their own authority and limitation to resolve nonperforming loans at internal level.

Thirdly, the study also covers what measures Vietnamese authorities have been implemented to resolve current situation in Vietnam. Many efforts have been recognized such as enforcement of Decrees and Circulars concerning bad debt, and the most current one is Circular 02/2013/TT-NHNN (revised in Circular 09/2014/TT-NHNN). Most significant approach of the government is the foundation of Vietnam Asset Management Company in 2013, which attempts to purchase nonperforming loans from commercial banks and resell them to the interested. Its restriction and current achievement have also been investigated.

Statistics used in the paper are mainly extracted from the State Bank of Vietnam's publications. However, there are differences in Vietnamese publications and international credit ratings' observations as for two main rationales. The first one is that different standards in debt recognition and classification are applied among domestic commercial banks. The other reason is that Vietnam itself has different approach in nonperforming loan categorization. Therefore, challenges raised in this paper are essential for those interested in Vietnamese current issues.

As for further studies related to the topic, a research can initiate investigation from political and social background and how they can influence the nonperforming rate in Vietnam. Studies in banking risk management and how other countries with similar experience have conducted may also encourage further insights in such topic.

## 5.1 Suggestions

After investigation on current bad debts situation in Vietnam, accompanied by case studies of KAMCO and Danaharta, from the researcher's point of view, some amendments can be made to improve the situation. Those will be categorized for appropriate correspondents.

### 5.1.1 For VAMC

#### 5.1.1.1 Special powers in asset disposition

Properties accounts for a large part of collaterals transferred to VAMC, and under current situation, when real estate market is frozen, it is rather difficult to sell the asset. Moreover, Vietnam's land law still consists of many procedures which hinder the resolution asset. Under present law, even if the collateral is sold, ownership cannot be changed without approval of the property's owner, meaning debtor. Therefore, investors or interested entities still hesitate in purchasing assets.

Special powers regarding this matter should be granted for VAMC, maybe for a predefined period of time, so that asset disposition can progress properly and efficiently. However, this

approach cannot be used in long term, for granting special powers to VAMC also implies that current law is not sovereign. Therefore, this approach should be implemented only after appropriate amendments have been made to Vietnamese' land law.

#### 5.1.1.2 External governance

Current VAMC's board of governance only includes internal members, meaning representatives from the SBV and credit institutions. Therefore, some approaches may not be appropriate and affect the efficiency of asset disposition, as well as reflecting poor transparency of activities. External members can be financial analysts, university professors or doctorate holders in related field, or even international accounting firms. These members, with both academic and practical foundation, will possibly and accurately advise on pricing, evaluating and asset disposition. Moreover, with no official financial reports and disclosure, its progress cannot be evaluated. Even though VAMC is established as a centralized asset management company, it is still a financial institution; hence, transparency in operations should be demonstrated.

#### 5.1.2 For whole financial system

##### 5.1.2.1 Frequently updated and cross-checking customer database

An ample amount of NPLs is caused by poor transparency in customers' information. Besides Credit Information Center (CIC), where involved credit institutions update credit details concerning the clients, there is no other database for checking creditability, profitability, and accuracy in data of borrowers. Moreover, if there is an error input, "good" or payable debtors may be unable to borrow loans from other banks, and "bad" or unpromising debtors may obtain credit from different financial institutions. Therefore, data provided by customers should be re-evaluated before approval. Credit officers should be authorized to gain access into such as tax office's, customs office's, ministry of natural resources and environment office's database, hence having an objective perception of customers' creditability. For instance, whether loan's value exceeds a certain amount, data from related government offices and previous engaged credit intermediaries will be available for investigation. The disadvantage of this proposal is time-consuming and interdisciplinary involvement. However, this method will guarantee trustworthiness of data gathering, hence diminishing unrecoverable loans.

##### 5.1.2.2 Transparency in financial operations

In Vietnam, only a numbers of credit institutions actually have their financial and annual reports audited by international accounting firms. It is understandable since the expenses may



seem uninteresting for small-sized banks. However, only being audited, figures presented in reports are creditable for interest groups and potential investors. Transparency in financial operations also indirectly pressurizes banks for in-depth appraisal and approval of claims, thus reducing unprofitable lending.

Furthermore, in case of investments in affiliates, credit institutions should make a clear report in which the amount of funds used, field(s) of investment, and business plan are clarified. The purpose of this approach is to prevent commercial banks from investing in non-expert area or defined goals being unachievable.

#### 5.1.2.3 Restrictions on loans' value and claims

Depending on individual credit institution' size, capital and capabilities, loan's value and number of claims from same borrower should be defined. The restriction on claims from same client is determined as well, irrespective of one or various banks involved. The approach is to guarantee liquidity and reduce credit risks for commercial banks. And for enterprises, those will not have excessive financial obligations if economic downturn occurs. The restriction can be adjusted if customer's proof of profitability, liquidity, achievable business plan is confirmed. Therefore, this approach's success rate largely depends on interdisciplinary database as addressed above.

#### 5.1.2.4 Improvement in appraisal stage

Credit officers who work in appraisal department will be supported to go to related seminars, courses held by credit institutions or provided in universities; or visit the bank's branches in different countries. For domestic courses, expenses will be covered by that financial institution. For trips outside of Vietnam, credit officers will be partly responsible for costs.

An internal committee is as well beneficial, especially for more comprehensive valuation. The committee may incorporate both credit officers from different branches and experts in relating area. To maintain confidentiality of clients' information, external members will only participate in evaluating collateral and estimating depreciation value in accordance with loan tenor. External members can only be employed for certain amount of time, for reducing misfortune of business secrets' leakage and maintaining objectivity in appraisal stage.

#### 5.1.2.5 Countermeasures for nonperforming loans

Enough provisions for NPLs will help credit institutions in case such loans incur. Therefore, banks should identify possible loss, initiate supports for needed enterprises and reserve provi-

sions accordingly. Moreover, possible cases, which is likely be nonperforming in the near future, should be alerted in CIC system as well; hence other involved financial institutions can take appropriate measures as well.

Another option is to become enterprises' shareholders. The unpaid interest will be considered as payment for shares. With this approach, banks are able to participate in enterprises' future business plans. When the enterprises have recovered financially, the relationship may continue as long as both parties are still interested, or the corporate may reimburse the loans with appropriate loan rate to gain self-governance.

### 5.1.3 For the government

#### 5.1.3.1 Restriction on Loan-to-Deposit Ratio in financial institutions

In May 2010, the SBV's Circular No. 13/2010/TT-NHNN were issued, in which credit institutions were required to achieve the capital adequacy ratio of 80 percent. The ratio was determined to reduce liquidity risk of commercial banks in particular and the national banking system in general. The ratio is calculated on the basis of total loans over total customer deposit, or LDR. However, this was later amended by Circular No. 19/2010/TT-NHNN, in which floating rate was applied.

However, it is important to limit LDR in the current banking situations. In order to control banks' liquidity, stability and generate profit, LDR should be set to create healthy financial environment. There is currently a second draft on revised Circular 16/2010/TT-NHNN relating to the LDR ratio. If the draft is accepted, supply-demand relationship will be reflected more accurately, assisting the central bank in regulating credit flows in the market more explicitly.

#### 5.1.3.2 Assisting the national real estate market

##### 1. Price adjustment and interest rate deductibility

According to World Bank's database, Vietnam's GDP per capita has exceeded 1,000 USD, meaning Vietnam is now categorized as lower middle income country. Yet, housing prices are noticeably higher than the national average income; therefore, even there is a need, many people cannot afford to purchase. The gap between newly constructed houses or apartments and actual purchased ones are remarkable, thus leading to unreasonable pricing in real estate market as well. This dilemma can only be settled with the government's intervention. Depending on economic conditions, pricing flexibility should be implemented. Loans for housing should be granted at a more favorable rate and validate for a longer period. For instance, the rate would be set-

tled for 10 years' time, considering the debtor would be able to reimburse both principal and interests. Otherwise, the contract would be extended with new interest rate implemented at that time. The approach can only be successful if:

- Macroeconomic conditions have improved; debtors have more financial capabilities to engage in long-term loan tenor.
- Credit institutions receive financial support from the government, so that interest rate can be stabilized and reasonable for borrowers.
- Financial institutions have enough liquidity to engage in long-term lending period.
- Recapitalization of smaller credit institutions with larger banks is conducted; hence, those financial institutions will encounter fewer difficulties in liquidity and credit shortage.

## 2. Real estate laws and incentives for potential investors

Under current provisions, two main inadequacies can be identified. Firstly, without owners' approval, changes in ownership for sold properties cannot be processed, thus creating boundaries for asset disposition. Secondly, foreigners or Vietnamese living overseas cannot purchase properties legally in Vietnam, thus limiting foreign investment into national real estate market. Besides, current system consists of many procedures, which may discourage domestic investors. Therefore, appropriate amendments should be considered and implemented in the near future.

### 5.1.3.3 Consolidated appraisal system

Existing appraisal phrase is done separately from banks to banks, and there is no specific standard for pricing and evaluating collateral's value. If collateral is property, the value will fluctuate depending on economic conditions. Hence, usually expenses on loan recovery exceed the amount of credit granted for borrowers, taking into account depreciation of property over time and present land law in Vietnam. Therefore, a consolidated appraisal system should be organized.

The system should include representatives from the SBV and ministry of natural resources and environment, credit institutions, experts or experienced land brokers, and university professor or doctorate holder in related field. The rationale is to build an objective system insulating from political and subjective factors. These members will be authorized to investigate or participate in appraisal phrases of credit institutions, as well as drafting appropriate policies when needed.

#### 5.1.3.4 Favorable tax implementation

Assuming that VAMC successfully dispose an asset, subtracting expenses, distribution of gain-loss sharing agreement, reimbursement for government-backed bonds, capital surplus is inconsiderable. Yet, VAMC and involved credit institutions need to pay tax for the amount; hence, the conversion is not profitable for both VAMC and commercial banks. As banks also participate in finding potential buyers, tax deductibility will serve as an incentive for acceleration in asset recovery. Moreover, premium in NPL provisions and actual expenses on loan resolution should be legally deducted from total profit, thus implying reduction in payable tax amount.

### 5.2 Theoretical linkage

The theories applied in the particular research include ones related to nonperforming loan's rationales and its consequences, and two fundamental approaches in nonperforming loan resolution. Moreover, as the discussion is focused on centralization method, asset management and necessities of Asset Management Company are also mentioned.

These theories provide academic background for the researcher concerning impaired loan's concepts and how to resolve such; hence supporting empirical study on Vietnamese issue's evaluation and proposals for improvement.

### 5.3 Summary

Nonperforming loans are inevitable in any economies, especially concerning developing ones. However, considering how they adversely influence commercial banks in domestic level and the economy in national level, the government needs appropriate approaches to resolve such impairment loans.

The aim of the research is to investigate the current situation in Vietnam. The chapter covers how bad debts negatively affect commercial banks and Vietnamese economy, as well as current measures conducted by the government. In the particular research, experiences of Korea and Malaysia are also discussed as evaluation and recommendations for Vietnamese Asset Management Company.

The paper goes through literature review on the topic, research of Vietnamese performance and countermeasures against the issues with accompaniment of interviews with local credit officers.

The dissertation indicates slight improvement recorded from the government's efforts in impairment loan resolution. Since the establishment of Vietnam Asset Management Company is still recent, its contribution to the Vietnamese issues is yet to determine. Lacking in commercial banks' management, Vietnam Asset Management Company's authorities and government policies are also discussed as areas for improvement.

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## Appendix

### Interview Questionnaire

The answers achieved through interviews shall be kept as confidential and served as data resources for the particular bachelor thesis. Interviewees' identities will not be disclosed due to various reasons.

#### General Questions

1. Compared to one year ago, how do you perceive current financial prospects of the bank?
2. In which criteria do you believe the bank is improving or diminishing?

#### Questions concerning bad debts

1. In your opinion, why do impairment loans incur at the bank? Which factor is considered as the most influential? Could you please kindly provide any precedent cases?
2. Under circumstances of collateral resolution, are there any difficulties recorded during the process?
3. The internal process of debt restructuring may differ between banks. From your point of view, is the process effective at your bank?
4. Do you have any recommendations for current financial situation at the bank?