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CREDIT RISK MANAGEMENT AND BAD DEBT CONTROLLING

Case: ANZ Vietnam

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ABSTRACT

It can be seen that the Vietnamese economy in the first decade of the 21st century has a significant development in the banking sector. Commercial banks represent a big role in this development. The banks' capital rose rapidly and became an important factor in Vietnamese economic growth. However, a negative side always follows the result of any growth. Expanding operation leads to debt rate increase in most commercial banks. Especially bad debts rate rose rapidly. Bad debts became a serious problem for the Vietnamese economy.

When the amount of bad debts increases to a particular point, it will hinder the development as well as the operations of the banks. Due to this issue, controlling the bad debt rate is hard work for all commercial banks. There is no model of solution for all banks. According to specific characteristic of each bank, specific solutions to control bad debt rate are provided. However, those solutions seem to be not as effective as expected due to many reasons. When Vietnam became an official member of the World Trade Organization (WTO), the high bad debt rate brought many challenges. It reduced the banks' core competency as well as customer trust.

The objective of this thesis is evaluating credit risk management policies and investigating Australia and New Zealand (ANZ) Bank as a case study. Readers will get familiar with the risk management's concepts in banking business, understand more about the Vietnamese banking system and know more about the importance of credit risk management as well as controlling bad debt rate in the economy.

The research for this thesis is mainly done in ANZ Vietnam with the help of three employees and one manager of the Collections Department, Loan Assessment Department and Fraud Department. This thesis also tries to create a picture of the lending procedure and criteria of ANZ Vietnam. Moreover, the State Bank of Vietnam's regulations and policies are also investigated to contribute to the research. Because ANZ Vietnam is considered one of the best banks that has low bad debt rate, recommendations for other banks are provided.

Key words: Risk, banking risk, bad debt, credit risk, credit risk management

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GLOSSARY

AMC	Assets Management Corporation
ANZ	Australia and New Zealand Bank
CIC	Credit Information Center
CAD	Credit Approval Discretion
CP	Collective Provision
GDP	Gross Domestic Product
IFC	International Finance Corporation
IIA	Institute of Internal Auditors
IMF	International Monetary Fund
IP	Individual Provision
KAMCO	Korean Assets Management Corporation
R&D	Research and Development
SBV	State Bank of Vietnam
VND	Vietnam Dong, Vietnamese currency
WB	World Bank
WTO	World Trade Organization

1 INTRODUCTION

The introduction will give readers an overview about this thesis. Firstly, the background will present the reasons behind the choice of this thesis topic. Secondly, the research objective and research questions of this thesis are presented. In this chapter, readers will also understand about the theoretical framework and research methodology used in this thesis. Finally, the model of this thesis's structure will be presented.

1.1 Background

The decision for writing this thesis appeared when the bad debt rate in Vietnam increased 66% compared to the previous year (BBC November 2012) and became a serious threat to the economy. Taking a closer look at the Vietnamese banking system, Moody's Investor Services Corporations downgraded the Vietnamese Government's bond rating from B1 to B2 in September 2012. The reason for this downgrade is "*the Vietnamese banking system needs to have more support from the government to be stable*" (Global Credit Research 2012). High bad debt rate is the biggest problem of the Vietnam economy at this moment and needs to be solved as soon as possible.

According to Mr. Tuyen, former Minister of Department of Commerce, there are two reasons that caused the high bad debt rate in Vietnam. They are "*financial institutions extend lending for many private companies and state companies' investments without careful assessments so when those companies cannot make profit; it becomes bad debt*" and "*lacking of control from the government*". (BBC July 2012)

Moreover, Moody's also worries about the unclear information of the Vietnamese Government's data and that belongs to the reasons for Moody's downgrade (Global Credit Research 2012). In July 2012, the State Bank of Vietnam pronounced that the bad debt rate in Vietnam is 8.6% of the commercial banks' total debt until May 2012. However, the Director of the State Bank of Vietnam, Mr. Binh said this number is 10% at the same time (BBC July 2012). Which one is

the correct number still being a question, but the high bad debt rate has a big influence for the commercial banks.

During two recent years, the Vietnamese Government has been taking many actions to reform the banking system. However, there is not any clear strategy to solve the bad debt problem and the credit risk management of commercial banks is still very weak.

1.2 Research objectives and research questions

The main objective of this thesis is to research the bad debt rate in the Vietnamese commercial banks, to investigate it with the case study bank's experience. The aim is to create a credit risk management, which can offer solutions for the banks and financial institutions. With the data collected from ANZ Vietnam, a foreign bank that will be the case bank in this thesis, it will be a good example for the Vietnamese local banks.

The research questions are listed below. The first two main questions concern the bad debt rate in Vietnam. The third one is a sub-question about the case bank and its credit risk management:

1. What is bad debt and bad debt rate control in the Vietnamese banking system?
2. What is credit risk management and its effectiveness?

Sub-question:

3. How is ANZ Vietnam dealing with credit risk?

1.3 Limitations

The first limitation of this research is due to the bank's data secure and secrecy. It is impossible to access the unpublished data when not being an employee of ANZ Vietnam. Within the data collected from the ANZ Group's annual report and the interviews with the staff members of the case bank, this thesis will not provide a

totally accuracy picture about the ANZ Vietnam's financials. However, this thesis will focus on the solutions and policies used for credit risk management.

Since the primary goal of this research is about the bad debt rate of the Vietnamese banking system and the experience of ANZ Vietnam, other Vietnamese local banks will have less importance and will not be studied by detail. All common characteristics of them will be considered as the common characteristics of the whole Vietnamese banking system.

The last limitation is due to the limited statistics. Due to the political reasons, there are differences in many government reports and the information is usually not accurate. The statistics that are nearest to foreign reports will be used.

1.4 Theoretical framework

This part is going to go through the definitions of the basic key words that will be used in this thesis. It will help readers to have a chance to understand about risk concepts and many different kinds of banking risks.

Risk can appear in a bank, a company, a trading activity or even in human's normal life. Risk exists everywhere. Risk is "*the possibility of something bad happening at sometime in the future*" (Hornby 2006, 1264). In business, risk is defined as "*a possibility of financial loss*" (Dictionary of Finance and banking 2008, 386). Like other business, the banking business has to face with the banking risk. According to The Basel II Accords issued by The Basel Committee on Bank Supervision, there are three main types of risks in the banking business. They are credit risk, market risk and operational risk (Global Association of Risk Professional 2009). Another classification about the banking risks was introduced by Crouhy, Galai and Mark in "The Essentials of Risk Management" (2006) in figure 1.

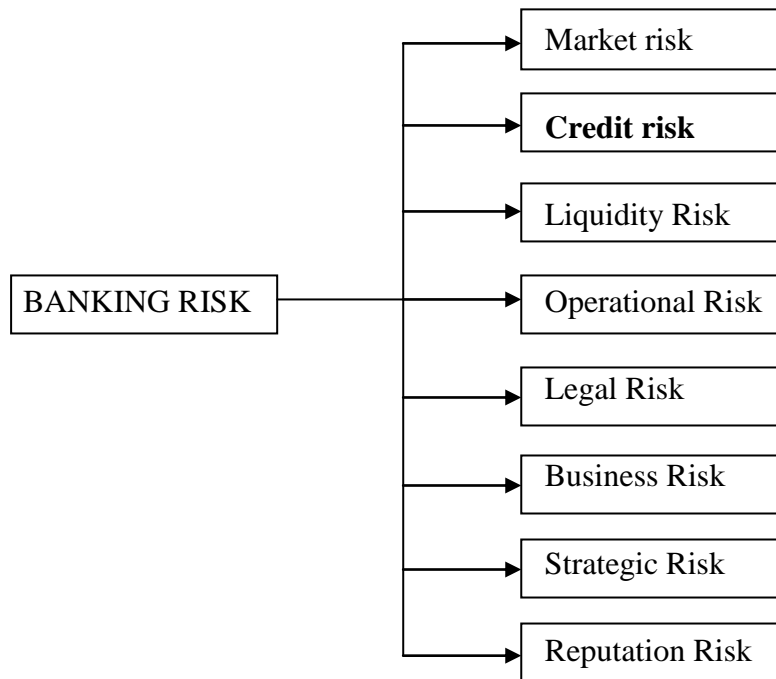


FIGURE 1.Types of banking risk (Croughy, Galai & Mark 2006, 26)

Banks have to deal with eight main types of risk as in the figure 1. They are market risk, credit risk, liquidity risk, operational risk, legal risk, business risk, strategic risk and reputation risk. It can be said that the banking business is extremely risky. Because main business of the bank is lending, the biggest risk is credit risk.

Among the types of banking risks, credit risk is the biggest threat that the banks have to prevent. Credit risk is very close to bad debt. Credit risk occurs when the debtors cannot pay back their loans and interest for the bank. In order to prevent the credit risk, the banks will use many solutions called credit risk management. The main cause of the credit risk is bad debt. Bad debt is an amount owed by a debtor that is unlikely to be paid (Dictionary of Finance and Banking 2008, 31). Bad debt rate is the percentage of the bad debt in the total debt of a bank or the whole banking system. The criteria to evaluate an overdue loan to become bad debt will be mentioned in part 2.2.

1.5 Research method and data collection

An overview of this thesis's methodology is presented in figure 2:

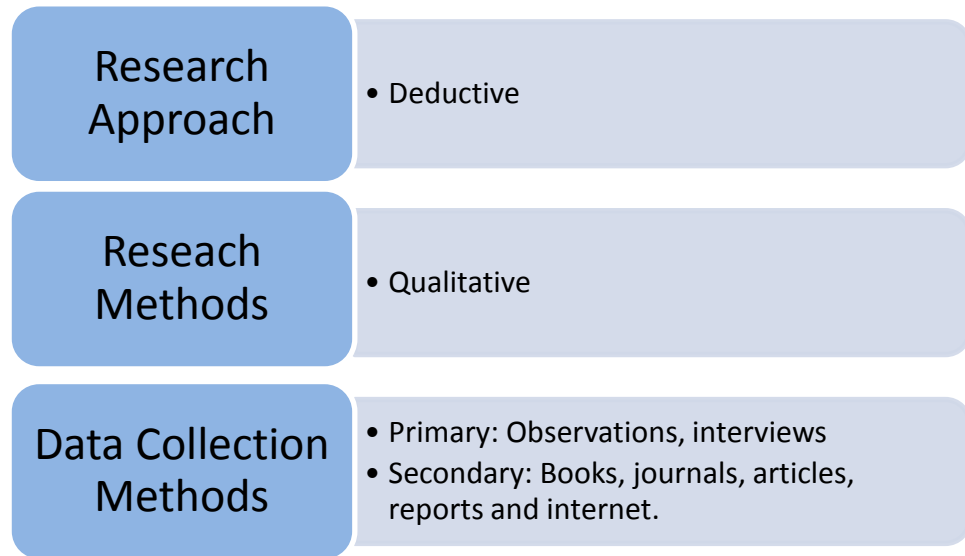


FIGURE 2. Research methodology

The two board methods of reasoning in research are deductive and inductive approach. Deductive research approach is informally called “top-down” approach because it works from the more general to the more specific. In the other hand, the inductive research approach moves from the specific observations to the broader generalizations and theories (Burney 2008). In this thesis, the research approach is deductive. In the beginning, this thesis will present the general picture about the banking system in Vietnam and the credit risk situation as well as credit risk management. After that in the case study bank, a more specific approach will be taken in order to understand the specific solutions that the case bank uses when dealing with many types of risks.

When doing a research, it is necessary to have a suitable research method in order to collect the research data. Qualitative Research aims to provide a complete, detail description of the research topic while quantitative research concentrates more on counting, classifying features and constructing statistical models and figures to expand what is observed. (Explorable 2011)

To answer the research questions in this thesis, the interviews with the ANZ Vietnam's employees are required. The interviews can offer additional information. Therefore, the qualitative research method is chosen in this thesis.

Research data is collected from both primary and secondary sources. The primary sources come from the interviews with the case bank's employees in the empirical part. The secondary sources, published and electronic sources, are used to contribute to the theoretical part of this research.

1.6 Structure of thesis

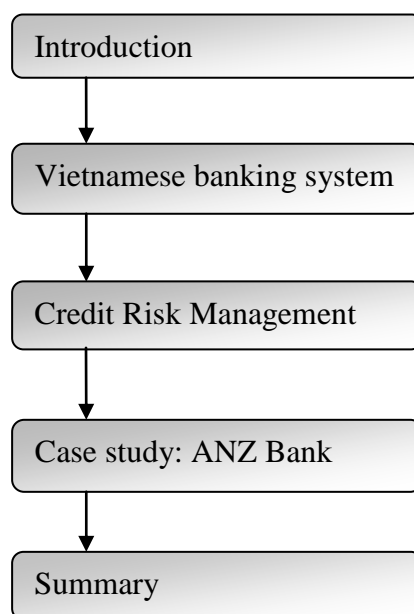


FIGURE 3. Structure of thesis

As displayed in the figure 3 above, this thesis is divided into 5 main parts. In the introduction, readers will get familiar with the theories related to banking and credit risk management. The next two following chapters will analyze the banking system in Vietnam and credit risk management. In the chapter 2, an overview look about the Vietnamese banking system will be provided. In this chapter, readers will understand more about bad debt rate and its consequences for the economy. Chapter 3 will present the theories about credit risk management. This chapter will present about the key factors of credit risk management, which can be used by the banks. The empirical part will start from chapter 4 when ANZ Vietnam is presented as the case study bank. In this chapter, readers will have a look about

ANZ Vietnam's credit risk management to understand the reason why ANZ Vietnam is among few banks that can keep the bad debt rate very low. After analyzing the case study bank, the recommendations for other banks and conclusion are provided. The final chapter is chapter 5 and it will be a summary of this thesis.

2 VIETNAMESE BANKING SYSTEM

Located in Southeast Asia, Vietnam is an emerging economy and on the way to become a new tiger of the region. After the great socio-economic reform that began 26 years ago, Vietnam changed from planned to market economy. Like any other business sectors, the banking system had many changes and improvements. The numbers of banks, banking products and services have been grown dramatically. The appearance of foreign banks in Vietnam also brought new challenges for the Vietnamese local banks and they need to restructure to adapt new competition. The restructuring of local banks included involvement of foreign financial experts and the route to increase the capital to 3,000 billion Vietnam Dong (VND) as minimum. All those actions aim to sustainability development and enough ability to compete with the foreign competitors. (Government's Decisions 141/2006ND – CP)

2.1 Overview

Like most other countries in the world, the State Bank of Vietnam (SBV) is a central bank on the top of the whole banking system and being the key macroeconomic institution in the country. The SBV has the following missions:

- *Formulate monetary and exchange rate policies*
- *License and supervise commercial banks to ensure the stability of the whole banking system.*
- *Issue banknotes and government bonds (Leung 2009, 53)*

Under the authority of SBV is a huge system of banks and financial institutions. By the time of December 2012, the Vietnamese banking system has 5 state-owned commercial banks, 37 joint-stock commercial banks, 54 branch offices of foreign banks, 5 foreign banks and more than 1,100 financial institutions. (Thao 2012)

The growth of the Vietnamese banking system can be seen through the increasing of capital and total assets, the numerous services and the annual contribution to the Gross Domestic Product (GDP). From 2006 to 2010, the total capital of the Vietnamese commercial banks increased 12 times, the total assets and deposit increased 16 times while the total lending increased about 14 times (Mui 2011).

TABLE 1. Percentage of banks' total assets compared to the whole banking system (Adapted from SBV's Report No. 49/BC – NHNN, 2010)

Type	2006	2007	2008	2009	2010
State-owned commercial banks	62.3	53.3	51.48	49.4	48.2
Joint-stock commercial banks	22.8	31.5	32.45	33.2	34.7
Foreign banks	9.8	9.6	10.26	11.43	11.89
Financial institutions	1.1	1.2	1.25	1.36	1.38

As can be seen in the table 1, from 2006 to 2010, the total assets of state-owned commercial banks had decreased while there is an increase in joint-stock commercial banks and foreign banks. This trend is not so hard to understand when the Vietnamese economy is more open to the world and not only depends on the state-owned firms like before. However, the state-owned banks still plays an important role in the economy and are a capital channel between the government and enterprises.

2.2 Bad debt and credit risk

Banking business, like any other types of business, faces with risks. The banking business in this modern time does not simply receive deposits and grant lending. The banks have to create many banking products and services for customers in order to compete with other competitors. Those various activities of the bank make the risks more complex.

The biggest risk that banks might face is credit risk. Credit risk happens when debtors are not able to pay back their loans and interests. It can be said bad debt is the main cause of the credit risk for the bank. In credit risk management, banks

need to control the bad debt by many ways. At least banks have to be able to predict and evaluate the credit risk situation. The main question in credit risk management is whether to approve the loan application of a specific customer or not. However, the banking business makes profit by lending, so customer evaluation and loan assessment is an important process. Good bad debt controlling will prevent credit risk. According to the SBV's Decisions No. 493/2005/QD-NHNN, there are five classes of debts as in the table 2 below:

TABLE 2. Class of debts (Adapted from SBV's Decision No. 493/2005/QD-NHNN)

Classes	Debts' criteria
<u>Class 1</u> : Normal	Debts that are not overdue yet or overdue below 10 days
<u>Class 2</u> : Noticed	Debts that are overdue from 10 days to below 30 days
<u>Class 3</u> : Under standard	Debts that are overdue from 30 days to below 90 days
<u>Class 4</u> : Doubtful	Debts that are overdue from 90 days to below 180 days
<u>Class 5</u> : Possibly loss	Debts that are overdue above 180 days and debtors are not able to pay

Debts from class 3 to 5 are the bad debts and they are main reasons of the credit risk for the bank. In the recent years, the increasing of debts from class 3 to 5 is becoming a significant problem for the Vietnamese banking system. Most of the Vietnamese banks do not have good preparation and when the bad debt situation becomes serious, many banks are in trouble.

2.3 Consequences of bad debt for the banks' operations

Bad debt brings a lot of trouble to the bank and it requires urgent solutions to avoid the damage. In case the debt collection process takes long time, the bank has to face with many serious consequences. Firstly, slow debt collection will

make the bank's cash quantity decrease. When the cash quantity is not strong, the bank cannot expand their lending and make any profit. The enterprises will not be able to get loans for their operations. If this situation happens through years, it will damage the development of the country's economy.

Secondly, there are many difficulties in the assets settlement. Normally, in order to get the loan approval, debtor has to have deposit asset in the bank based on the amount of the loan. When that loan becomes the bad debt, the bank will try to settle those deposit assets to get the money back. It is not an easy task for the bank. In fact, the banks face with many difficulties when settling those assets. In Vietnam, the most difficult problem is caused by the differences between many legal documents. According to the SBV's Policy No. 03/2001/TTLT-NHNN, the banks and financial institutions are not allowed to sell the debtors' deposit assets directly to collect money without debtors' permissions. In the Article III of this SBV's Policy, the banks can only send the debtors to court or sell the debtors' deposit assets by auction. However, this rule is different from another Decision of SBV. The Decision No. 178 allows the banks to sell the deposit assets directly even without debtors' permissions (Tuyen 2009). It will lead to the following difficulties in reality:

- In the lending contract, the banks usually have this condition: *"In case debtor breaks the payment schedule that mentioned in this contract, the bank has the right to sell the deposit assets for collection purpose"* (Tuyen 2009). In fact, it is impossible to sell the deposit asset if the bank cannot deal with debtor to get permission. The bank can only send that debtor to court. (SBV's Policy No. 03/2001/TTLT-NHNN)
- Even after sending the debtors to court, there are still many difficulties for the banks. The legislation of Vietnam is not strict enough and the execution period takes quite long. Normally, it takes 2 years from the day sending the debtor to court until the time the court's decision is executed. (Tuyen 2009)
- Another trouble that banks usually face is the deposit asset cannot be sold. In case those assets are expensive machinery, they are very hard to be sold. Moreover, the bank needs to pay taxes because most of the machinery are fixed assets and are exempt from taxes. (Tuyen 2009)

Finally, according to the SBV policy, the banks need to control the bad debt rate below 9% of the total debt. If any bank operated in Vietnam has the bad debt rate above 9%, the SBV will have punishment for that bank (SBV's Decisions No. 493/2005/QD-NHNN). Information about the bank with the high bad debt in the Vietnamese banking system also has bad impact to that bank's reputation.

2.4 The bad debt situation in Vietnam

On 25 January 2013, one of the four biggest state-owned banks of Vietnam, Agribank, published a report about its bad debt rate. Until 31 December 2012, the bad debt rate of Agribank is above 1 billion EUR, about 5.8% of the total debt (Hien 2013). At the same time, there are also the statistics about the bad debt rate of three other state-owned banks. Specifically, the total bad debt of the four biggest state-owned banks is more than 1.67 billion EUR (Hien 2013). In the following table 3, detail numbers about the bad debts of the four biggest state-owned banks in 2012 will be provided:

TABLE 3. The four biggest state-owned banks bad debt situation until 31 December 2012 (Na 2013)

	Total debt		Bad debt	
	Amount	Growth (%)	Amount	Bad debt rate (%)
Agribank	17.6	8.2	1	5.8
BIDV	11.9	16.2	0.329	2.77
Vietcombank	8.8	15.2	0.198	2.25
Vietinbank	12.1	13.3	0.164	1.35

(Amount in Billion EUR, the growth is the percentage compare to 2011)

As can be seen in the table 3, Agribank is the bank having the highest bad debt rate in the state-owned bank sector and in the whole Vietnamese banking system also. It is the result of the loose management in a long time and the expanding of

lending without careful assessment. In Vietnam, there is a strong relationship between state companies and state-owned banks. The main role of the state-owned banks is providing capital for the state companies. State companies still play an important role in the economy, however, the efficiency of them when using the capital is quite low and not explicit. Due to that reason, the state companies can easily make bankrupt if crisis period happens and therefore unable to pay debts.

Here is a simple example about how the bad debt is generated. There is a state-owned company doing a 1 million EUR real estate project. Normally, the company can make a loan up to 70% of the project. In this case, the bank will approve a loan with an amount of 700,000 EUR for that company. However, it is not usually happening. Because of the strong relationship between the state companies and the state-owned banks, the project's value will be increased to a fake number for example 3 million EUR and the bank's staff will easily approve for a loan up to 70% of 3 million EUR. The bank's staff can receive from the company 5% of the total loan as the compensation. In most cases, the bank will not be able to find out the true due to lacking of credit risk controlling and loose management. When the crisis comes, the company is impossible to sell real estate, and 70% of the 3 million EUR loan will become the bad debt for the bank. Lacking of credit risk controlling and explicitness are the two biggest problems of the Vietnamese economy. These problems not only increase the bad debt rate but also being a reason for foreign credit rating corporations such as Moody's, Standard & Poor's or Fitch to downgrade the Vietnamese economy.

Compare to the state-owned banks, the bad debt rates of the joint-stock commercial banks are also very high. Figure 4 below will show the bad debt rates of the Vietnamese banks in the nine first months of 2012:

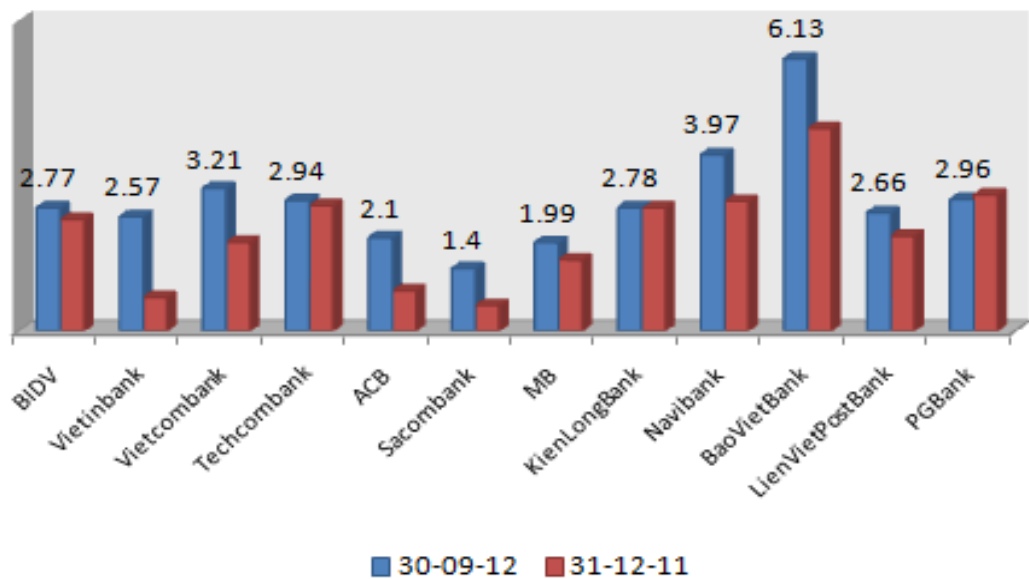


FIGURE 4. The bad debt rate of Vietnamese banks (Thanh 2012)

In the figure 4, there are three stated-owned banks and the other are commercial banks. Three stated-owned banks are BIDV, Vietin Bank and Vietcom Bank that mentioned in the table 3. The figure 4 provided the number until 30 September 2012 while the table 3 provided the number until 31 December 2012. It can be seen that BIDV keeps the bad debt rate of 2.77% until the end of the year while the two other state-owned banks reduced the bad debt rate from 2.57% and 3.21% to 2.25% and 1.35% continuously. In the figure 4, it can be seen that the commercial banks also have very high bad debt rate also. However, the total debt of the commercial banks is not as high as the stated-owned banks. That is the reason that made the bad debt situation of the commercial banks is high but not as serious as bad debt of the state-owned banks. (Thanh 2012)

Only in the foreign banks sector, the bad debt rate is under good control. It is not so difficult to understand; strong management, explicit activities and credit risk experience through long history operation are the key factors that made the foreign banks control the bad debt and credit risk very well in Vietnam.

Concerning the whole Vietnamese banking system, the bad debt rate is the most urgent issue at this moment. As mentioned in the beginning of this research, the data and number provided by the Government is unclear and not explicit. In a report, the SBV pronounced bad debt rate in Vietnam is 8.6% until May 2012

while the Director of the SBV said that number is 10% (BBC July 2012). Therefore, real bad debt rate of the whole banking system is still a mystery. In the Financial Magazine, November 2012, Professor Mui explained about the reason of different bad debt rate between the SBV's report and the number provided by the Director of SBV. This difference occurs because the debt classification issues by the SBV and the bank's internal rating is not so common. There are five classes of debt and the debts belong to class 3 to 5 are the bad debts. However, in most banks, the internal credit rating has some differences with the debt classification issued by the SBV and it varies between banks. When it has to be evaluated if a loan is bad debt or not, there will be different results between banks and the SBV. (Mui 2012)

2.5 Bad debt rate controlling suggestion for the Vietnamese banking system

In the beginning of this year, the Prime Minister of Vietnam pronounced that bad debt rate controlling is the most important mission of the economy and bad debt rate controlling plans need to start immediately (Dung 2013). Years ago, there were many countries has the same situation as Vietnam nowadays. That fact raises a question for the Government as well as the banks: **What Vietnam will learn from those countries and which implementation will be suitable?**

According to the Prime Minister of Vietnam, bad debt rate controlling campaign for the Vietnam economy will include two parts. Firstly, the current bad debt amount needs to be settled. Secondly, the SBV should review the policies related to credit risk management and promulgate new policies if needed. The SBV also needs stronger management with banks especially the banks with high bad debt and increases the supervision. These two parts needed to be done immediately and at the same time. (Dung 2013)

The first part of the bad debt rate controlling campaign is to settle the current bad debt amount and it is a very hard task. However, it is not impossible due to the experience Vietnam can get from other countries. Moreover, Vietnam also has its own experience after the economy crisis in most Asian countries during 1997-1998. In 1998, Vietnam had to settle a quite huge amount of bad debt that belongs to commercial banks and financial institutions. That amount was 10.11% of the

total debt as in an SBV's report (Hung 2012). At this moment, the number is from 8.6 to 10% but more serious because it represents 11% of the GDP of Vietnam (Muoi & Natasha 2012). Therefore, with the same rate, the bad debt amount now is much more than the amount in 1998.

In Korea, extending of lending without strong management used to be the weakest point in the economy's infrastructure. When the crisis came in 1997, many investors withdrew their money out of Korea and a huge amount of capital was going out of the economy. That led to the credit crisis and the monetary crisis in that country. Until March 1998, the bad debt rate in Korea is 18% and represent 27% of the GDP with the amount more than 108 billion USD (Hung 2012). At this time, the Korean Government settled that huge amount of bad debt by dividing that amount into two half. The banks are forced to settle one-half of bad debts by selling the assets that are deposited by the debtors and by using the banks' own capital. Korean Assets Management Corporation (KAMCO) is established to buy the remaining one-half of bad debt. The KAMCO is under control of the Ministry of Finance & Economy and the Development Bank of Korea (Hung 2012). The KAMCO's roles in the bad debt settlement are demonstrated in the following figure 5.

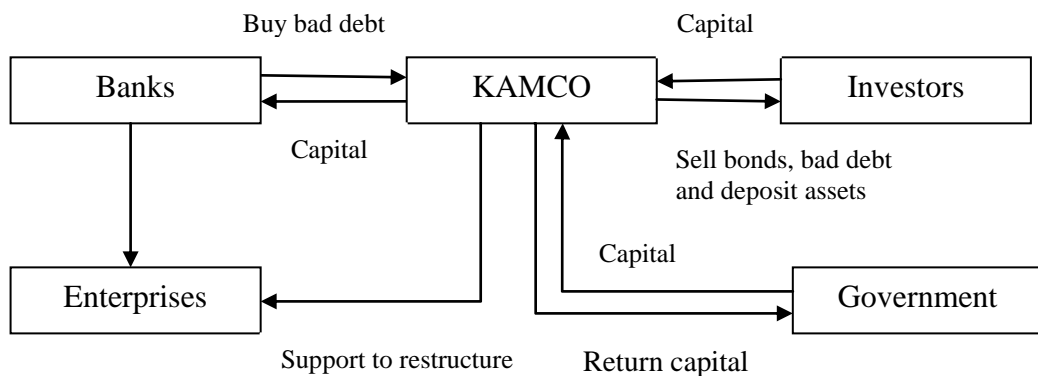


FIGURE 5. The KAMCO's role in bad debt settlement in Korea (Hung 2012)

The main role of KAMCO is using the capital from the Government to buy bad debts of the banks. Bad debt can be assets, which debtors deposited at the bank when applying for a loan. After that, the KAMCO will sell those assets or bonds for the investors. With those actions of KAMCO, the banks can get rid of bad

debt. The enterprises which being debtors will also receive the support from KAMCO to restructure and can overcome the crisis period. At that time, Korea had successfully attracted the foreign investors to come and invest in KAMCO and this action pushed many Korean investors to join the market. The result of this campaign is the bad debt rate decreased from 18% in 1998 to 3.9% in 2002. (Hung 2012)

Many other countries in Asia such as Japan, China and Thailand had the same solution as Korea for the bad debt settlement. Among those countries, China is the country that had many similarities as Vietnam. Chinese state-owned banks and state-owned companies have strong relationship and lack of explicitness. In the crisis time, the state-owned companies generated a huge amount of bad debt for the banking system. It took China over 13 years from 1990 to 2003 to settle this amount of bad debt. As the KAMCO of Korea, Assets Management Corporation (AMC) is established to buy bad debt and debtors' deposited assets to resell them. While Korea achieved good result in bad debt settlement, for the AMC of China, it was very difficult to settle the bad debts due to lacking of explicitness. (Hung 2012)

Lessons from two Asian countries, Korea and China, are very useful for Vietnam to settle the bad debts and control the bad debt rate. Due to macroeconomic reasons, Vietnam cannot do the same as Korea or China. The bad debt situation in Vietnam has many differences. According to Mr. Darryl Dong, an expert from the International Finance Corporation (IFC), Vietnam cannot do as China or Korea. Emerging economies like Vietnam are the place where the market for buying the bad debts and resell them has not developed yet (Lan 2012). A financial expert of World Bank (WB) at Vietnam, Mr. Sameer Goyal, had presented about Vietnam's bad debts at a seminar in Hanoi. From his point of view, firstly Vietnam has to restructure the state-owned banks as well as the state-owned companies. The Government has to promulgate stronger policies to ensure that every bank has a careful assessment when dealing with a loan application. From Mr. Goyal's point of view, the purpose of this action is to minimize the new bad debt and at the same time, government has to establish a national company to buy the bad debt like KAMCO or AMC. These two actions need to be done at the same time and have the same importance (Financial Plus 2012).

Currently, the Vietnamese Government is having many strong actions to settle the current bad debts and some positive results have been achieved. The campaign of bad debt controlling is still having many struggles. In a near future, Vietnam will be able to solve the bad debt problem. At that time, the next mission of the Vietnamese banking system is to prevent the high bad debt rate to happen again. In order to achieve that mission, strong credit risk management must be focused. In the next chapter, the credit risk management at the bank level will be studied.

3 CREDIT RISK MANAGEMENT

While the previous chapter is concerned the bad debt, credit risk as well as the consequence for the Vietnam banking system, this chapter will deal with the theories about credit risk management at the bank level in order to solve the research problem: define credit risk management and evaluate the effectiveness. In this chapter, the general principles of credit risk management at the bank level will be studied.

3.1 Credit analysis

In a simple way, credit can be defined as “*nothing but the expectation of a sum of money within some limited time*” and credit risk is “*the chance that this expectation will not be met*” (Caouette, Altman, Narayanan & Nimmo 2008). Therefore, credit risk management is the procedures that the bank will use to avoid losing money and controlling the bad debt rate. In the book *Managing credit risk: the great challenge for the global financial market* (2008), four authors Caouette, Altman, Narayanan and Nimmo presented in a simple way about credit risk management. According to them, there is a similarity between a bank dealing with credit risk and a tailor creating a suit for a customer – “*carefully measuring customer’s need and capacities to make sure the financing is a good fit*” (Caouette, Altman, Narayanan, Nimmo 2008, xv). Specifically, credit risk management is a process of analysis whose objective is to “*look at both borrower and the lending facility being propose and to assign a risk rating*” (Caouette, Altman, Narayanan, Nimmo 2008, 106). The main point of the credit analysis process is shown in the figure 6 below:

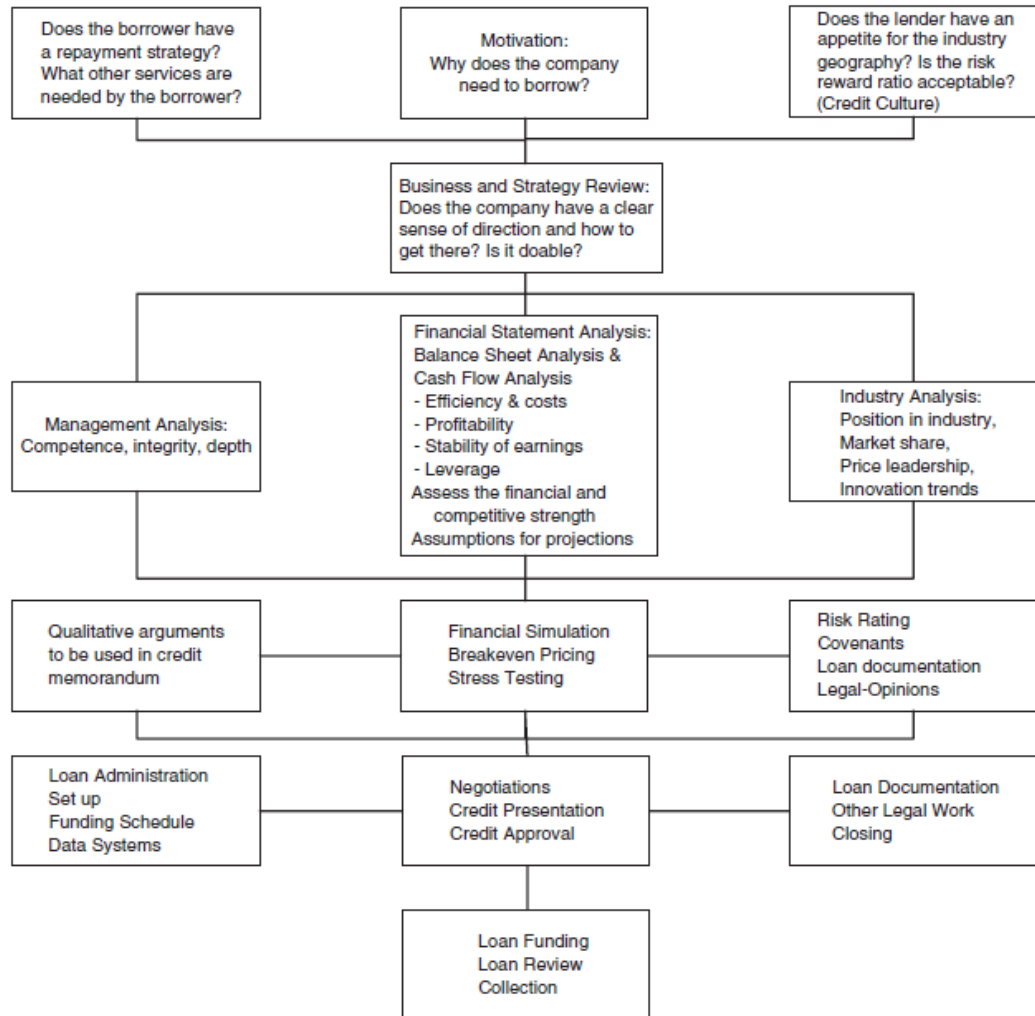


FIGURE 6. Credit analysis process (Caouette, Altman, Narayanan & Nimmo 2008, 108)

Credit analysis is a powerful tool to answer the most important question of any bank. That question is whether to approve a loan for a specific customer or not. Banking business makes profit by lending and lending with the lowest risk is the goal that any bank aims to. In reality, the bank's relationship officers usually make credit analysis in the first round. That is analyzing the customer's behavior as well as the documents. With their experience, the relationship officers try to find out any unusual point about the customer in order to verify the information. After that, the lending procedure and loan assessment will take actions and decide to approve or reject a loan application. The lending procedure and assessment will be mentioned more specific in part 4.2.1.

The figure 6 provides a list of the important tasks and questions that the banks should follow in credit analysis. The banks nowadays are not only deal with personal customers but also corporate customers. In fact, corporate customers generate most profit for the bank with very big loans. However, corporate customers could become huge debtors in case their firms have financial problems. The figure 6 also gives necessary criteria when doing credit analysis such as the industry analysis and the companies' financial statement analysis.

Beside the list of the important tasks and questions that the banks use in credit analysis, the banks also create other tools for this purpose such as internal credit rating system. Internal credit rating system is one powerful tool that the banks used to analyze the data of customer and facilities. The internal credit rating system is the complex systems used in loan approval, portfolio monitoring and management reporting. These systems analyze the adequacy of the loan-loss reserves or capital, the profitability and the loan-pricing analysis (William & Mark 2000, 168). With these systems, the credit risk is identified and measured properly. When applying for a loan, debtors need to provide the information such as identities, financial data, credit status etc. This system will automatically make calculations based on that information and the result will be called the credit rate. In order to calculate this rate, the bank has to find the factors that can affect to the credit portfolio, assign the weights and sum up to get the score. In the case study bank, a qualified customer needs to have at least 8 point to get a loan approval (adapted from the interview). In order to assign the obligor rating, the bank will require a list of aspects of borrower to consider (SBP's report). This list will be found in the Appendix 1. Moreover, the banks also use the policies and strategies to minimize the credit risk that can appear.

3.2 Credit policies and strategies

In order to control the bad debt rate and credit risk, every bank has the credit policies. Normally, those policies will include risk identification, risk measurement, risk grading techniques, risk control techniques and other document about legal issues (Bangladesh Bank report 2005). Also in this report, Bangladesh Bank pointed out that the credit policies and strategies are very important to the

bank's operation. Because of that reason, credit policies and strategies need to be approved by the bank's Board of Director and need to be reviewed annually to keep it current. Those policies are the guidance for the bank's employees to make them easier when dealing with many type of lending such as Private Customer, Corporate, Auto Finance, Mortgage etc. Good credit policies need to have the following criteria:

- *Provide detail credit evaluation*
- *Provide risk identification, measurement, monitoring and control*
- *Define the target market, risk acceptance criteria, credit approval authority and guideline to portfolio management. (Bangladesh Bank report, 2005)*

Greuning and Bratanovic (2009) divided credit risk into three main kinds based on their aims. The policies in the first group aim to limit or reduce the credit risk. The second one aims to classify the assets while the third set aim to loss provision (Greuning & Bratanovic 2009, 162). Due to large operation, there can be many types of written policy that made by the bank. However, the most important policy is the lending guidelines, which will be mentioned in the chapter 3.3.

Beside the credit policies, credit risk strategies are also important for any bank. The main purpose of the credit risk strategies is to determine the risk appetite of the bank. "*Credit risk strategies are designed to optimize return while credit risk is kept within the predetermined limit.*" (Bangladesh Bank report 2005.) Like the credit policies, credit strategies must get the approval of the bank's Board of Director. In the guidelines of Bangladesh Bank about credit strategies, there are the following fundamental points:

- *Credit strategies should include a statement of the bank's willingness to grant facilities based on the type of economic activity, currency, geographical location, market etc. Target market, business sectors, level of diversification and concentration, cost of bad debt and cost of granting credit are also key points that should be focused.*
- *Credit strategies should delineate the bank's overall risk that related to credit risk. Grant credit plans should base on various analyses.*
- *Credit strategies should provide the pricing strategies. (Bangladesh Bank 2005)*

3.3 Lending guidelines

Lending guidelines are established by the bank as the official instructions use in the bank's main activity, lending. Lending guidelines, in general, are an important tools that will help the bank's staff members when dealing with loan applications. Lending guidelines include many rules that can be applied to various types of lending such as Auto Finance, Mortgage, Term Loan, Home Loan etc. It can be said lending guidelines are the combinations of many lending policies for numerous types of lending. The mortgage lending policy, for example, will be a list that would specify how the mortgage loans are organized, assessment, approved, supervised and collected. The lending policies also include the following fundamental points:

- *Lending authority*
- *Type of loans and distribution by category*
- *Appraisal process*
- *Loan pricing and maturities*
- *Collection monitoring*
- *Limit on total outstanding loan. (Greuning & Bratanovic 2009, 166–170)*

As lending is the most risky task of the bank, the lending guidelines obviously are not simple. Each task in the lending guidelines consists of many terms and conditions and need to be checked by plenty of people in the bank, from staff members to managers. It is a process that takes times and needs to be done carefully if the bank wants to prevent the credit risk.

At the bank level, credit analysis, credit policies, credit strategies and lending guidelines are the three core methods that are used in the credit risk management. Based on three core methods, the bank can have many practical ways to control the bad debt and credit risk. In the next chapter, ANZ Vietnam will be analyzed as the case bank to understand how the bank organizes credit risk management methods in reality.

4 CASE STUDY: ANZ VIETNAM BANK

Established in 1835, ANZ is one of the oldest banks in Australia. For more than 175 years of development, ANZ become one of the four biggest banks in Australia, the largest banking group in New Zealand and Pacific and among the top 50 banks in the world. ANZ has started its operation in Vietnam since 1993. After 20 years doing business in Vietnam, ANZ Vietnam is among the top three foreign banks in this country. ANZ Vietnam has eight subsidiaries and transaction offices in Hanoi, Ho Chi Minh City and one representative office in Can Tho Province. With the strong capital and many banking business experience achieved for more than 175 years, ANZ Vietnam has developed dramatically. In Vietnamese market, ANZ provides many banking products and services such as credit cards, auto finance, mortgage etc. (ANZ Vietnam's homepage). ANZ Vietnam also has the strong credit risk management that this chapter will analyze.

Research data in this chapter is also collected from the ANZ Vietnam's staff members and manager through the interviews. Due to the bank's data secure and secrecy, the respondents required that their identities must be confidential. There were four interviews taken with three ANZ Vietnam's staff members and one manager. Their currently departments are belong to credit risk management of ANZ Vietnam. List of interview question is enclosed in the Appendix 2.

4.1 Credit risk of ANZ Vietnam

Currently, ANZ Vietnam is the second largest foreign bank in Vietnam. ANZ Vietnam offers various banking products and services that are listed in the following table 4. The credit risk can be found in every type of loans listed below. The loans are either in Vietnam Dong (VND) or in United State Dollar (USD). (ANZ's homepage)

TABLE 4. Banking products and services of ANZ Vietnam (Adapted from ANZ's home page)

Personal Banking	Corporate Banking
<ul style="list-style-type: none"> - ANZ Visa Debit Card - ANZ Visa Credit Card - Overseas study loans - Auto Finance - Mortgage - Personal consumer loan - Insurance - Investment loan 	<ul style="list-style-type: none"> - ANZ eBiz service - ANZ POS - Term loans - Investment loan

With various banking products and services, ANZ Vietnam has to deal with many credit risks. Banking is an extremely risky business and the banks have to accept it. Being the second largest foreign bank in the country, ANZ Vietnam's target market aims to high-class customers in the society. However, those customers will become bad debtors in case they are not able to pay back their loans for the bank. These loans usually have huge amount; they can bring big profit for the bank but will become huge bad debt in crisis period if the debtors are not able to pay.

As in the interview with Ms. K who is an employee of the Collections Department, there are three main kinds of banking products and services generate most bad debts for the bank. They are credit card, auto finance and mortgage. In many other countries, people are quite familiar with credit card while in Vietnam; credit card appeared few recent years so customer's awareness about credit card is still low. Many people think that credit card is an easy way to expend without cash but do not have a clear financial plan to pay back for the bank on the due date. Auto finance and mortgage are kinds of loan that support the customer to buy a car or a house. Those two kinds of loan are among the main loans of ANZ Vietnam. However, when they become bad debt, their consequence is also very dangerous.

Currently, ANZ Vietnam is one of the banks that have the lowest bad debt rate in the whole banking system. In order to achieve this result, there is a strong system to manage the credit risk at ANZ Vietnam. This system will be explained in the next chapter.

4.2 ANZ Vietnam's risk management

In general, credit risk management is an important mission of ANZ Vietnam. The mother bank, ANZ Australia, brings to Vietnam many strict policies and requirements to prevent credit risk. Compared to other Vietnamese local banks, level of awareness about credit risk is many times higher and the risk controlling process is organized more complicated and more professional at ANZ Vietnam. From the interview, Mr. Q who is a manager of ANZ Vietnam pointed out that there are three core parts of credit risk management. They are Lending Procedure, Loan Loss Provision and Collections Department. In the following chapters, those three parts will be analyzed to figure out a picture about ANZ Vietnam's credit risk management.

4.2.1 Lending procedure

Since the time when a specific customer applies for a loan until the moment when that customer receives the money, the applicant's loan documents will be transfer between numerous of the bank's staff members and managers. It is called the lending procedure. Assessment is the most important part in the lending procedure. The lending procedure is the core process of credit risk management and quite complicated. In most of Vietnamese local banks, this procedure depends on the bank's policies. Normally, there are only few people can make the decision for loan approval. At ANZ Vietnam, the lending procedure bases on the international standards and be adapted from ANZ Australia. A model of lending procedure at ANZ Vietnam is shown in the following figure 7:

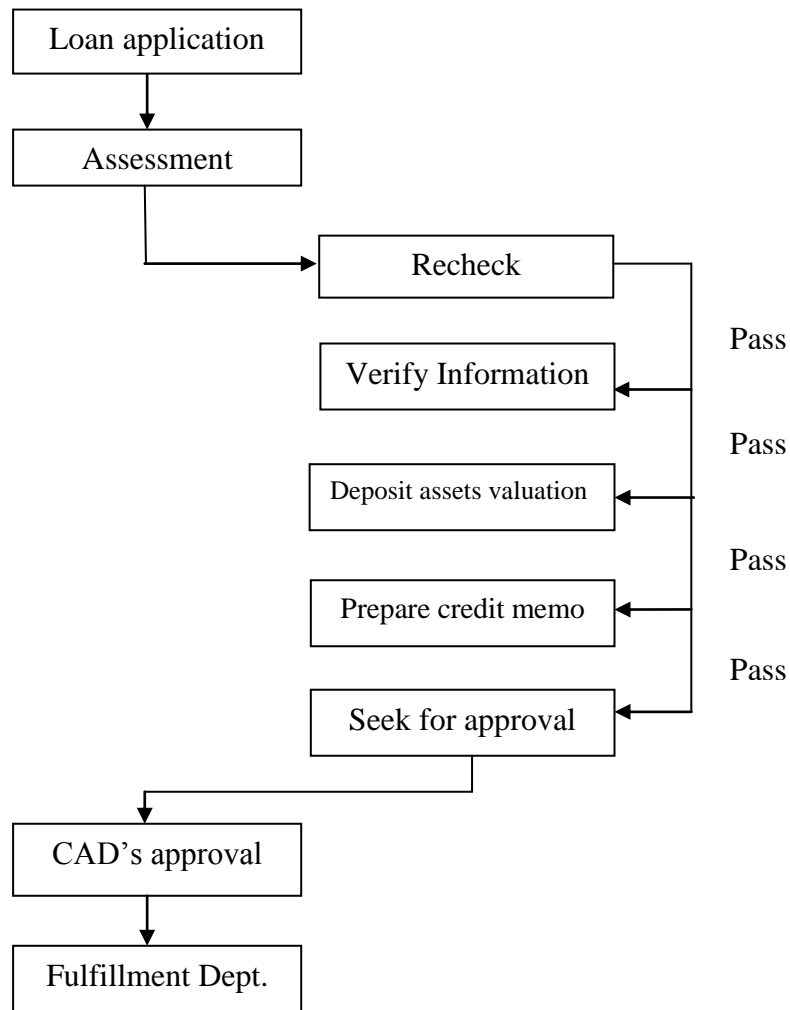


FIGURE 7. The lending procedure of ANZ Vietnam (Adapted from interview with Mr. Y, Assessment staff)

At the first step of the lending procedure, the customer will fill a loan application. Sale Officer is usually responsible for this first step. After that, the loan application and other documents will be sent to the Assessment Department. At this point, the most important part of the lending procedure begins. In order to control credit risk, careful and explicit assessment process is required. Firstly, the Assessment Department will recheck all applications. If there are any mistakes in the application form or documents lacking, that application will be kicked out.

Only qualified applications are delivered to the next steps in order to save costs and time.

The next two steps in the assessment process are verifying information and valuating the deposit assets. The assessment staffs will use their skills to verify the applicants' information such as salary, address etc. and valuating the assets that the applicants' deposit in order to give them a suitable lending limit. Compared to other local banks, ANZ Vietnam uses international standard when verifying customer's information. This is one of the biggest differences of the credit risk management between a foreign bank as ANZ Vietnam and the local banks. In Vietnam, the SBV has a data system called the Credit Information Center (CIC). In the CIC, there is full of information of every customer, who used to borrow a loan from any bank (cic.org.vn). When accessing the CIC, the bank's staff members will be able to see the credit record and create a credit history of customers. There is not only the bad debt but also a "one day overdue loan" is updated to the CIC. The CIC is a modern and complete system in Vietnam. The Vietnamese local banks use only the CIC to check customer credit's background while ANZ Vietnam uses other data systems beside the CIC to verify customer. The CIC only provides the credit history of customer but lacking of the data about terrorism financing and money laundering. If a customer is a member of a money-laundering network or come from terrorism groups, ANZ Vietnam will reject to do any transaction.

ANZ Vietnam has the Anti-Money Laundering and Counter-Terrorism Financing Policies that can be found in Appendix 3. It can be seen that ANZ Vietnam has a high awareness of these issues. In the future, when Vietnam will be more open and join the international economy, it is necessary to increase the awareness of money laundering issues and terrorism financing.

When an application is qualified after the assessment, a credit memo will be prepared by the bank's staff member to seek the CAD's approval. CAD is stand for Credit Approval Discretion and CAD Holder is a person who can make approval for a loan. At ANZ, there is a clear system of the CAD Holders and this system is divided by the loan's amount. For example, the CAD Holder of ANZ Vietnam is only able to approve for the loans maximum 10 million USD. If over

that amount, ANZ Vietnam needs to seek the approval from the CAD Holder in ANZ Asia Pacific. When the loan is over 100 million USD, the approval from ANZ Australia is required (adapted from the interview with Mr. Y). The CAD Holders' level of ANZ is not only clear but also explicit and it makes ANZ easier to prevent the credit risk. Most Vietnamese local banks do not have this clear system and the branch manager usually makes the loan approval decisions. If a customer has close relation with the branch manager, it is possible for that customer to get the approval for a big loan. In fact, this situation happens usually in Vietnam and being a huge problem for the SBV in order to control the bad debt rate in the whole banking system.

Finally, after got the CAD's approval, the loan application will be sent to the Fulfillment Department. This is the last point of the lending procedure. Customer will receive the money and the loan application is complete. It can be said the lending procedure at ANZ Vietnam is completely explicit, based on the international standard and having many strong actions to control the bad debt and credit risk. Vietnamese local banks have to restructure and built an explicit lending procedure as ANZ did. This action will improve the credit risk management's effectiveness many times.

4.2.2 Loan-loss provision

Loan-loss provision is an important term of the bank's credit risk management. The International Monetary Fund (IMF) defines the loan-loss provision as the net allowances that the banks make against the bad or impaired loan (IMF 2004). Loan-loss provision is "*a noncash expense that is reported in the bank's income statement and this expense are charged to the bank's earnings when adding to the allowance*" (Business Glossary Dictionary). In the simple word, loan-loss provision is an amount of money that the bank reserves to cover any unexpected loan loss. When granting any loan the bank needs to have the loan-loss provision and this action will prevent the bank from bankruptcy. The loan-loss provision is among three core parts of ANZ Vietnam's credit risk management. In February 2013, the SBV promulgated the Circular No. 02/2013/TT-NHNN that mention clearly about new loan-loss provision policies for the banks. According to that

Circular, the loan-loss provision ratio for the classes of debt is presented in the following table 5:

TABLE 5. The loan-loss provision ratio for the classes of debt (Adapted from Circular No. 02/2013/TT-NHNN)

Classes of debt	Loan-loss provision ratio
Class 1	0%
Class 2	5%
Class 3	20%
Class 4	50%
Class 5	100%

As in the table 5, the loan-loss provision ratio increase from class 1 to class 5. Class 5 is the debts that are considered can be loss. Banks are required to set the loan-loss provision ratio to 100% of the loan amount for debts belong to class 5 (Circular No. 02/2013/TT-NHNN). For example, there is a customer that applies a loan with the value 100,000 USD. When that customer's loan belongs to class 2 of debt, overdue from 10 days to below 30 days, the bank needs to reserve 5% of the loan amount. This reserve amount increases step by step and when the customer's loan is overdue above 180 days and belongs to class 5, the bank need to reserve 100% of the loan amount. In this case, the bank needs to reserve 100,000 USD. This reserving amount is use to prevent the bank from bankruptcy.

This action of the SBV is the first step that belongs to the bad debt settlement campaign. Actually, this loan-loss provision ratio is not a very new policy for the banks. The banks currently have the loan-loss provision but only depend on the banks' own policies. With this new Circular, the SBV hopes that the bad debt rate will reduce in year 2013.

Currently, the Collections Department is responsible for the loan-loss provision of ANZ Vietnam. Among three main parts of ANZ Vietnam's credit risk

management, the Collections Department is the final one and will be presented in the following chapter.

4.2.3 Collections Department

From the bank's point of view, it has to use many ways to collect the overdue loans to prevent loss. At ANZ Vietnam, the Collections Department is responsible for loan collection. The Collections Department is required to collect the overdue loans and by collecting the overdue loans, the bad debt rate will be able to control. Controlling bad debt rate is the most important mission of the Collections Department. According to the SBV's policy, the bank needs to control the bad debt rate below 9% of the total debt or will be forced to stop operating in Vietnam (SBV's Decision No. 493/2005/QD-NHNN). The Collections Department is responsible for this target. If the Sale Department has the sale target every month, the Debt Collections also has target that is to control the bad debt rate to be below 9%. However, 9% is a peak that the bank is not allowed to exceed. At ANZ Vietnam, this number is about 4.3% (adapted from the interviews). If a product or service, such as the credit card, generates more than 4.3% bad debt, this product or service will be stopped to offer to the customer anymore. At that time, the bank needs to use its own capital to settle this bad debt amount. The following figure 8 will show the structure of the Collections Department at ANZ Vietnam:

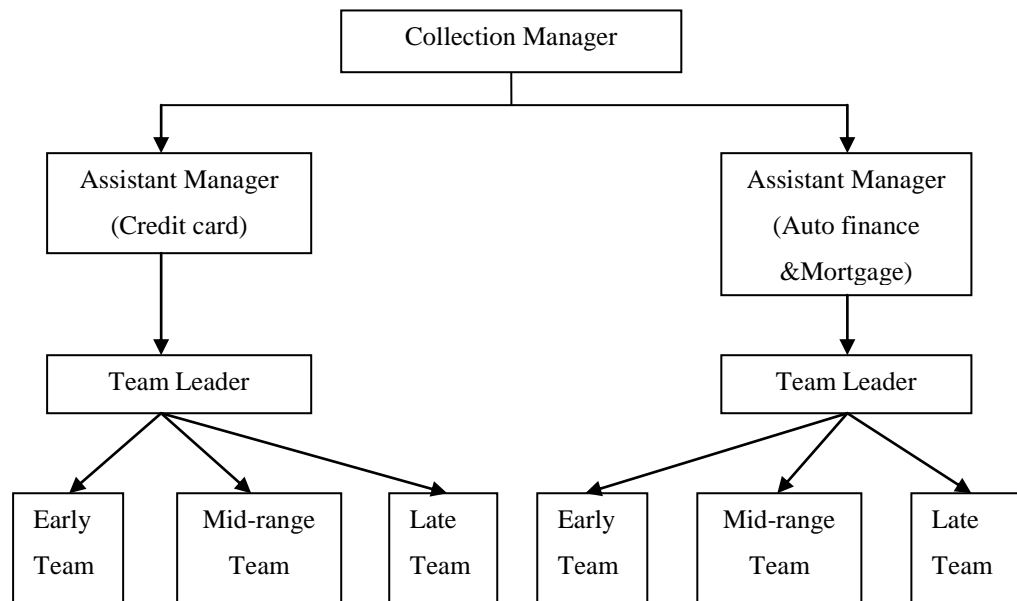


FIGURE 8. The Collections Department's structure at ANZ Vietnam (adapted from the interviews with Ms. K, Collections Department)

The structure of the Collections Department of ANZ Vietnam is divided into two main parts. They are Credit Card Collections and Auto Finance & Mortgage Collections. Below the Collections Manager, there are two Assistant Managers for those two main parts. Each part will consist of three teams. They are Early Team, Mid-range Team and Late Team. In the Decisions No. 493/2005/QD-NHNN of the SBV about the debt classification, there are five classes of debt as mentions in the table 2. Depend on the class of debt, Early Team, Mid-range Team or Late Team will take the actions.

At the Collections Department, the Early Team will deal with the debts belong to class 1 and 2. This is the first step of the Collection Procedure. The system automatically sends the lists of loans that overdue below 30 days to the Early Team. According to Ms. K, over 70% of the loans in the Early Team's data are normal. It means the debtors have the paying capacity but just forget to pay on the due date because of many different reasons. In this first step of the Collection Procedure, the customer service is very important and needs to be focused because the debts below 30 days are not the bad debts. The main task of the Early Team is to remind the customers to pay their loans. Strong actions in order to push the

debtors to pay their loans are strongly prohibited. The Mid-range Team is responsible for the debts belong to class 3. The debts, if exceed 30 days, will be automatically transferred from the Early Team to the Mid-range Team and if the debtors still do not pay, it will be transferred to the Late Team. Not as the Early Team, the bad debt in the Mid-range Team is more difficult to handle and more than 50% of them will be able to be loss. The requirements for the employees working in the Mid-range Team are the negotiation skills and able to work under pressure. Most of the debtors, whose debts are overdue more than 30 days, will ask for the delay payment. The staff members need to have the negotiation skill for the collecting money purpose for the bank. The Late Team has to deal with the hardest task in the Collection Procedure. At this time, the debts have become the bad debts and have the high loss possibility. When the debts are overdue above 90 days, it is impossible to negotiate or hope that the debtors will pay in the near future. The bank needs to take any necessary actions to collect the money and minimize the risk of loss that can happen. The Late Team's staff members are usually over 35 years old. They must have more than 10 years of experience and must have the strong knowledge about the law. When dealing with a bad debt case, the Late Team will take the following actions that are adapted from the interviews:

- Evaluate the loss probability
- Estimate the debtors' deposit assets
- Contact the local police and ask for more information
- Prepare to send the debtors to court

The Collections Manager needs to lead the employees to achieve the target, to control the bad debt rate. Teamwork is very important in the Collection Procedure. Having the first contact with debtors, the Early Team has to support and provide the necessary information about the debtors' attitude for the Mid-range and the Late Team.

At ANZ Vietnam, the Collections Department is also responsible for the loan-loss provision. Compared to other Vietnamese local banks, ANZ Vietnam does the loan-loss provision more careful and base on the ANZ Australia's policies. ANZ Vietnam has to follow both the SBV's and the ANZ Australia's policies when

operating in Vietnam. In case there are any policy that different between the SBV and the ANZ Australia, ANZ Vietnam needs to follow both of them. As mentioned in the table 5, the SBV requires the loan-loss provision ratio 100% when the debts belong to class 5. However, a manager of ANZ Vietnam, Mr. Q said in the interview that ANZ Australia requires the loan-loss provision ratio 100% for any debt that overdue over 30 days. It is equivalent to the debt of class 3 in the SBV's policy (SBV Decision No. 493/2005/QD-NHNN). In this case, ANZ Vietnam has to follow the ANZ Australia's policy because it is suitable with the SBV's policy also. The loan-loss collection provision is made by the Collections Department because the Collections has the contact with the debtor and follow the debtor's data.

At ANZ Vietnam, the loan-loss provision is divides into two parts. They are Individual Provision (IP) and Collective Provision (CP). IP is the money that the banks reserve for a specific individual loan. CP is the reservation for the loss that can happen to the bank, which the IP was not able to cover. This division is based on the SBV's policy. The SBV requires that the IP and the CP are two kinds of the loan-loss provision that the banks need to reserve (SBV's Circular 02/2013/TT-NHNN).

The Collection Department will follow and update the IP for every debtor. Although this action is done automatically, it still needs to be checked manually. The CP is update monthly by analyzing the monthly report (adapted from the interview with Mr. Q).

The Collections Department also gives the reports about debtors to the Research and Development (R&D) Department for the analysis purpose. While the credit analysis process mentioned in the figure 6 analyze the loan applicants, the R&D Department will focus on the debtors' analysis. Based on the information about the debtors' data provided by the Collections Department, the R&D Department will create the customer categorization. This action helps the bank know about types of customer that are most likely to generate the bad debt. Types of loan that generate most bad debts are also available for the bank to preview. In the interview, Mr. Q confirmed that ANZ Vietnam is sometime unable to predict the bad debt situation and those analyses help the bank to improve their performance.

In this chapter, readers have gone through the ANZ Vietnam's credit risk management. It can be seen that the three main parts of ANZ Vietnam's credit risk management consist of the involvement of many departments. In the next chapter, readers will have a more specific look about the ANZ Vietnam's structure for credit risk management.

4.3 ANZ Vietnam's credit risk management structure

As mentioned in the previous chapter, there are three main parts of credit risk management at ANZ Vietnam. They are lending procedure, loan-loss provision and Collections Department. Those three parts prevent the credit risk in a full loan circle. Firstly, the lending procedure will begin to prevent the risk when a loan is in the application period. After that, the loan-loss provision will reserve an amount in case the loan-loss happens and the Collections Department will try to collect the overdue loan to reduce the bad debt rate. However, the credit risk management at ANZ Vietnam is not simply base on the loan circle. There are various departments belong to the credit risk management to achieve the highest result. Compared to other local banks, ANZ Vietnam creates a more complex structure to prevent the credit risk. In the following figure 9 is an example about the basic structure of a Vietnamese local bank:

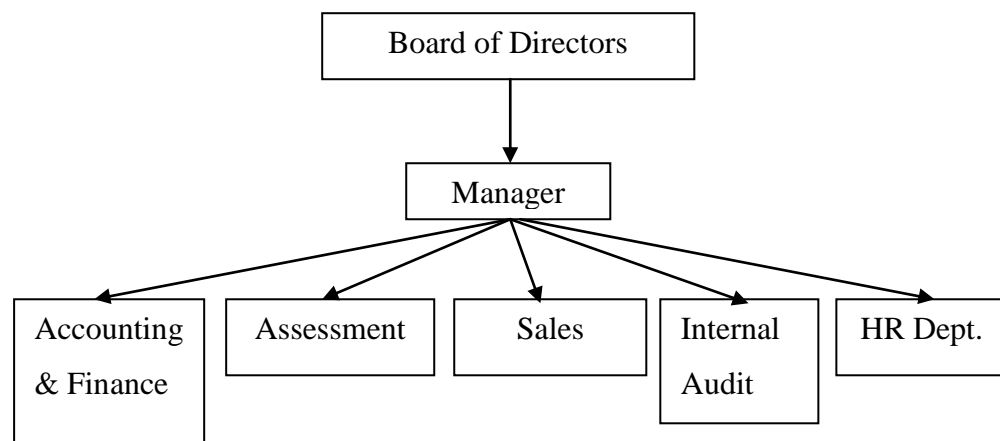


FIGURE 9. Basic structure of Vietin Bank (Adapted from Vietin Bank homepage)

The structure of Vietin Bank in the figure 9 is quite common in most Vietnamese local banks. However, this kind of structure showed the weaknesses. In the interview, Mr. Q emphasized that the ANZ Vietnam's structure is organized for the credit risk management purpose and it is one reason that made this bank can remain the bad debt rate very low. Mr. Q also listed three differences of the structure between ANZ Vietnam and other local banks. They are the differences about the Frauds Department and the double-check system that lacking in most local banks. The last one is the differences in the structure of the Internal Audit Department between ANZ Vietnam and other local banks.

4.3.1 Internal Audit and Double-check system

In the figure 9, it can be seen that the Internal Audit of Vietin Bank is under the Manager's authority. As defined by the Institute of Internal Auditors (IIA), internal audit is *"an independent, objective assurance and consulting activity designed to add value and improve an organization's operation"*. It has the mission to improve the effectiveness of risk management (Cornell University). As mentioned in part 2.4 about the credit risk of the Vietnamese banking system, the strong relationship between loan applicants and the banks is one reason that cause the bad debt. Having the relationship with the bank can make the loan applicants easily to get the big loan without careful assessment. The managers of Vietin Bank can control the Internal Audit Department and it can bring the risk to the bank. In case the manager wants to grant a big loan for his relative and gives order to skip the full assessment process, the Internal Audit can see that action is able to bring the credit risk to the bank. However, the Internal Audit cannot take any actions because this department is under control of that manager. At ANZ Vietnam, the Internal Audit is not under authority of any person or department. Even the CEO of ANZ Vietnam or the CEO of ANZ Australia Banking Group cannot control the Internal Audit Department. This department is responsible for many things related to the bank's operation. *"Internal Audit's mission is ensuring the reliability and integrity of information; compliance with policies and other legal issues; the efficient use of assets and resource"* (Cornell University).

When not under the authority of any person or department, the Internal Audit can do their tasks freely and explicitly. In order to ensure the good credit risk management, the Internal Audit's results is send to the double-check system, which is also an independent department.

The double-check system is a system that is available for the ANZ Regions and the ANZ Australia. ANZ Asia Pacific is responsible for double-check every result from the Internal Audit of ANZ Vietnam and ANZ Australia will do double-check on the ANZ Asia Pacific's results. It is really a powerful tool to help ANZ Australia to control the credit risk at many levels. Therefore, this system can ensure that the risk management in every country and even the ANZ's branches or transaction office is under control.

As mentioned in the beginning of this thesis about the Moody's Investor Service, the unclear information of the Vietnamese Government's data is one of the reasons for Moody's downgrade (Global Credit Research 2012). It is quite hard to know the exact number in the reports of Vietnam due to lacking of the explicitness. After receiving reports from the Vietnamese local banks, the SBV is difficult to check the reliability of those reports. It is the reason of the differences in many SBV's reports. Concerning the bad debt rate, Vietnamese local banks usually reduce the bad debt rate in their reports in order to avoid the punishment of the SBV. Reducing the loan-loss provision is another purpose for the banks to provide untrue bad debt rate. In this moment, Vietnamese local banks can create any number that they want because the double-check system is lacking of effectiveness.

At ANZ Vietnam, the numbers in all the reports are true. It is impossible to create any fake number for any purposes due to the good double-check system. If the bad debt rate is high, it is necessary to face the truth and take the actions to solve the problem. It is called the sustainable development strategy that ANZ Vietnam has been following since its established day. (Adapted from the interview with Mr. Q)

It will take time for Vietnamese local banks to have a strong double-check system as ANZ's. However, the local banks need to think to restructure for the sustainable development. The Internal Audit is needs to be independent and it is

the first thing that the Vietnamese local banks can do immediately to prevent credit risk.

4.3.2 Frauds Department

The Fraud Department's two main missions are investigation every fraud activities inside the bank's organization and prevention the fraud activities that come from outside. In a document about the Fraud Policy issued by ANZ (2012), the Fraud Department has the following mission:

- *Maintain preventive and detective systems, controls and strategies to protect its customers, shareholders and employees against the risks of fraud*
- *Identify, assess, document and control fraud risks associated with all activities, including products, processes and delivery channels*
- *Conduct appropriate screening of prospective employees and contractors*
- *Refer internal fraud matters to the police.*

(ANZ Fraud Policy 2012)

Like the Internal Audit department, the Fraud Department is an independent department. Although not directly belongs to the credit risk management; the Fraud Department has strong support to the credit risk management. An example about the fraud activities can be the fake documents about income that the loan applicants will use to get the loan approval. The Fraud Department will use plenty of tools to investigate any doubtful application and support the credit risk management. In most Vietnamese local banks' structure, the fraud controlling usually belongs to the Assessment Department. This structure cannot maximize the effectiveness of the fraud controlling due to lacking of independent (Adapted from the interview with Mr. D, Fraud Department). Moreover, the Fraud Department of ANZ Vietnam also prevents the economic spies from other banks that work as employees at ANZ.

4.4 Credit practices and performance

This chapter will include the information about the ANZ Vietnam's credit practices that compliance with the SBV's and the bank's policies to understand how the bank is performing. In the interview, all four ANZ Vietnam's employees cannot provide a full financial picture about the bank. With the limited numbers from the interviews and the annual reports, a simple credit statistics of ANZ Vietnam will be provided in this chapter.

4.4.1 Compliance with the State Bank of Vietnam's policies

As a foreign bank that operates in the country, it is compulsory for ANZ Vietnam to obey the SBV's policies. As mentioned earlier, there are several legislations issued by the SBV concerning the credit risk. The rules about debt classification and loan-loss provision (Decision No. 493/2005/ND-NHNN) and the Circular No. 02/2013/TT-NHNN about the loan-loss provision are the two most important policies about bad debt controlling. The SBV's Decision No. 1627/2001/QD-NHNN about provision on lending by credit institution is also an important policy that every bank has to comply. The SBV also has many documents related to the lending policies that all credit institutions need to follow. To ensure that all employees know clearly about the SBV's policies, ANZ Vietnam has plenty of training documents and seminars for employees especially the staff members in the transaction office.

ANZ Vietnam has the high awareness about compliance with the SBV's policies. In fact, there is no other choice because the SBV's investigators inspect the bank's operation frequently. As preventing the credit risk is not a simple mission, ANZ Vietnam also gives the experience from ANZ Australia to help the SBV to improve the effectiveness of those policies. By totally comply with the SBV's policies; ANZ received many awards from the SBV as well as the Vietnamese Government. (ANZ's homepage)

4.4.2 Compliance with the bank policies

Like any other bank, ANZ Vietnam also has its own policies beside the SBV's. Those policies are built based on the bank's own characteristic, missions and operation. As mentioned in part 3.2, the credit policies are issued by the bank to prevent the credit risk. In most local banks, the Board of Directors approves the policies. ANZ Vietnam is a foreign bank therefore most policies are issued by ANZ Australia. The Board of Directors only issues several specific policies that are suitable for the Vietnamese market (adapted from the interviews with Mr. Q).

In the interview, Mr. Q was asked to describe every type of the credit policies at the bank. That manager is not allowed to tell any policies in detail. However, the credit policies of ANZ Vietnam are divided into three groups based on the policies' aims. They are policies that aim to reduce the credit risk, classify the assets and the loan-loss provision. This division of policies is exactly what Greuning and Bratanovic (2009) had mentioned.

Most of the policies in the first two groups, which aim to reduce the credit risk and classify the assets, are related to the lending procedure. As mentioned previously, the lending procedure is one of three important parts of the ANZ Vietnam credit risk management. Every employee who is involved in the lending procedure and the Assessment Department needs to know clearly about those policies. Mr. Q, who has previous experience in another Vietnamese local bank, said in the interview that ANZ Vietnam is very strict with its employees to ensure the compliance with the bank's policies. The employees have to attend the training quarterly with the assessment about the policies. If any person is not qualified, the bank will terminate the labor contract.

The third group of policies that aims to the loan-loss provision is a little more complicated. The SBV has its own rules about the loan-loss provision and so do ANZ Australia. ANZ Vietnam has to follow the SBV's policies as well as the policies of ANZ Australia. It requires many calculations to create a loan-loss provision that can comply with both the SBV and the ANZ Australia's policies.

No matter issued by the SBV or the ANZ Australia, the policies are important to prevent the credit risk at the bank level. ANZ Vietnam has the high awareness

about the necessary of compliance with policies. By using many tools, ANZ Vietnam can that ensure every employee should know clearly about the policies. The Internal Audit Department also creates many competitions between the departments to encourage the employees increase their knowledge about policies. (Adapted from interview with Mr. Q)

4.4.3 Credit performance statistics

In the previous parts, there were many analyses about the ANZ Vietnam's credit risk management. This section will deal with the bank's result about the credit activities. However, as mentioned before, the ANZ Vietnam's employees rejected to give the full statistic about the credit performance in the interview due to the bank's secrecy. The numbers in this part are limited and most of them are collected from the bank's annual report.

As mentioned before, the loan-loss provision is among three core parts of the ANZ Vietnam's credit risk management. The loan-loss provision of ANZ Vietnam has to comply with the ANZ Group's policies and this provision amount is calculated to ANZ Group's income statement. The loan-loss provision is divided into two parts, the IP and the CP as presented in part 4.2.3. In the annual report (2012), ANZ Group released the numbers about its IP and CP. Until 30 September 2012, the IP increased \$426 million compared to 2011 while the CP reduced by \$391 million.

ANZ Vietnam also has the fast development speed. The credit growth of this bank is mention in the following table 6:

TABLE 6. Credit performance statistics (Adapted from the interview with Mr. Q)

	2010	2011	2012
Credit growth	+ 4.7%	+ 5.4%	+ 6.7%
Bad debt/total debt	1.12%	2.7%	1.3%

In the table 6, there are the key numbers about the credit performance of ANZ Vietnam. It can be seen that during 2010-2011, the bad debt rate of ANZ Vietnam increased significantly. It is not so difficult to understand when 2010 was a hard time for the Vietnamese economy. The financial crisis happened, the inflation increased to 23% until September 2010. Many companies had to face with trouble and unable to pay back their loans for the bank (BBC October 2011). It is the reason why the bad debt rate of ANZ Vietnam as well as the whole banking system increased dramatically in this period. However, with its own experiences and the good structure of credit risk management, ANZ Vietnam was able to reduce the bad debt rate from 2.7% to 1.3% in 2012. In fact, this bad debt rate of ANZ Vietnam is very low when comparing to other local banks that mentioned in the figure 4. This number is the result of many good policies as well as the actions ANZ Vietnam did during the crisis time to control the bad debt at the lowest point.

Beside controlling the bad debt, ANZ Vietnam also has the strong credit growth with the record number 6.7% in 2012. As Vietnam is an emerging economy, there are plenty of opportunities for ANZ Vietnam to expand its business in this country. With the best quality of banking products and services and very low bad debt rate, the reputation of ANZ Vietnam is increasing in the eyes of customer as well as the shareholders. It is very good experience that other Vietnamese local banks can learn.

4.5 Conclusion and recommendations

Finally, this thesis is going through the experience of ANZ Vietnam's credit risk management. Readers are able to understand about the reason why ANZ Vietnam can keep the low bad debt rate. This chapter will close the study by providing answers for the research questions in the first chapter of this thesis. The recommendations for Vietnamese local banks are also presented. The following table 7 will show brief answers for research questions of this thesis.

TABLE 7. Brief answers of research questions

Research question	Brief answers
What is bad debt and bad debt rate control in the Vietnamese banking system?	Bad debt is an amount owed by a debtor that is unlikely to be paid. Bad debt rate is bad debt percentage of the total debt of a bank or the whole banking system. Bad debt rate is control under many policies issued by SBV or banks.
What is credit risk management and its effectiveness?	Credit analysis, credit policies & strategies and lending guidelines are 3 general principal of credit risk management. Its effectiveness in Vietnam is low due to loose management.
How is ANZ Vietnam dealing with credit risk?	ANZ Vietnam can remain bad debt at low percentage due to very good structure of credit risk management. Credit activities are well-controlled at many levels

The first question was answered based on the theories about bad debt to give readers the first look about the topic of this thesis. The bad debt is a problem of the Vietnamese banking system at this moment. Most of the banks in Vietnam especially the state-owned banks have the extremely high bad debt rate. It is the result of the loose management and the inexplicit credit activities, which many banks have been doing recent years. At the macroeconomics level, the SBV's supervision role is also weak and the policies are not strict enough.

In order to control the bad debt rate, the credit risk management is an important task. By going through the general principles about the credit risk management, the answer of the second research question gives readers some knowledge about how the bad debt can be controlled. Credit analysis is the tool the banks use to analyze the customer data in order to make the loan approval decision. The policies and strategies are also aims to provide a risk control techniques for the banks. The last principle of credit risk management is the lending guideline. In fact, the lending guideline is a combination of many lending policies that issued by the bank for its staff members when dealing with a loan application.

After going through the banking system as well as the bad debt situation in Vietnam, the case bank was investigated in order to answer the third research question. With a look at many departments, policies, as well as tools, which ANZ Vietnam uses to prevent the credit risk. This analysis has given readers an overview about the ANZ Vietnam's credit risk experience. It can be said that ANZ Vietnam has created a strong system of credit risk management. This thesis is continued with the recommendations for Vietnamese local banks.

From the author's point of view, the biggest difference between Vietnamese local banks and foreign banks such as ANZ Vietnam is the structure. Vietnamese local banks need to be restructured and the new structure should be more explicit. As mentioned in part 2.4, the strong relationship between the banks and debtors is the biggest reason why the bad debt occur. With the structure of ANZ Vietnam, it can be seen that the credit activities are well controlled. With the double-check system, every credit activity is transparent. In case any staff member does wrong and can bring the credit risk to the bank, the Internal Audit and Fraud Department

can easily find it out. This is a very good point that Vietnamese local banks can learn.

Moreover, compliance with the policies is also an important task for Vietnamese local banks. Vietnamese local banks have many good policies concerning credit activities but the staff members still are able to commit fraudulent credit activities. It is necessary for the bank to increase the supervision and to conduct implementation of policies from the smallest transaction office to the headquarters. Policy training seminars are also needed and employees' policy knowledge should be checked regularly.

Last but not least, Vietnamese local banks should pay more attention to the loan-loss provision. The SBV has very clear policies about loan-loss provision. However, the loan-loss provisions of Vietnamese local banks remain very low. Loan-loss provision is very important to prevent the bank from bankruptcy and the bank should increase the awareness about this issue.

In brief, Vietnamese local banks should do many things in order to improve their credit risk management. However, the most important things are restructuring, compliance with policies and taking loan-loss provision seriously. Those core actions will help the banks increase credit risk management significantly.

5 SUMMARY

This thesis has been designed to analyze the Vietnamese banking system and the case bank in order to solve the research problems. The main objective of this thesis concerned bad debt and credit risk management in Vietnam. With the data collected from many sources, it can be seen that bad debt is a serious problem in the Vietnamese banking system at this moment. The second objective of this thesis concerned the definition of credit risk management to find the solutions for Vietnamese banks and by analyzing the case bank ANZ Vietnam. The recommendations for Vietnamese local banks were provided.

This thesis started with the background part. After that, the research questions were built to guide the whole study and research. The theoretical framework provided readers basic knowledge related to credit risk and bad debt. Qualitative research method was chosen for this thesis. Therefore, interviews with the bank employees were applied. The following part concerned the banking system in Vietnam. In this part, the key data of the whole banking system was provided to analyze the bad debt situation. After that, this thesis continued with credit risk management and the case bank. More specific views about how the banks deal with credit risk were presented.

The data used in this thesis was collected mostly from books and online resources. They were all updated and reliable resources. Moreover, careful assessment of those resources has been done, so that the author can assure this thesis is reliable. In the empirical part about the case bank, the interviews with the bank employees and manager were applied. With the experience in banking business, the interviewees gave a reliable look at the picture of the banking system. Although this thesis could not create a financial picture, many other things related to the credit risk management of the case banks are investigated. All of them can be valuable experience for other Vietnamese local banks.

To summarize, this thesis provides readers both theoretical and empirical information about the bad debt situation in the whole banking system in Vietnam, credit risk management and recommendations for Vietnamese local banks based on ANZ Vietnam's experience.

Some recommendations for the future studies are the deeper investigation into the credit performance statistics of the bank. With more detailed numbers in credit activities, it is easier to create a complete picture of the bank performance when trying to control the bad debt. Another recommendation is related to Vietnamese local banks. In this thesis, Vietnamese local banks had less importance and were not studied in detail. However, the local banks network is huge and has important points, which can be studied to understand more about the whole banking system.

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Ms. K. 2013. Collections staff. ANZ Vietnam. 22 February 2013

Mr. D. 2013. Fraud Department staff. ANZ Vietnam. 25 February 2013

APPENDICES

Appendix 1

List of aspects of borrower that bank will require for internal credit rating system
(Adapted from SBP's report)

- A. Financial Condition including:
 - a. Economic and financial situation
 - b. Leverage
 - c. Profitability
 - d. Cash flows
- B. Management and ownership structure:
 - a. Ownership structure
 - b. Management and quality of internal controls
 - c. Promptness/assessment of the willingness to pay
 - d. Strength of sponsors
- C. Quality factors:
 - a. CIB report
 - b. Sector of business
 - c. Industry properties and its future prospects
- D. Others:
 - a. Country risk
 - b. Comparison to external rating

Credit information from other sources

Appendix 2

Interview questionnaire

This interview's content is confidential and serves the purpose of collecting data for the final bachelor thesis. The researcher guarantees not to disclose respondents' identities in the work.

General Questions

1. Credit service is a traditional and key service in every bank. What are the credit services that ANZ Vietnam is offering?
2. In your opinion, what type of risk exists in those services?

Question related to credit risk management

1. Any bank has to deal with credit risk. How is the credit risk situation that your bank is dealing with? How many types of credit risk? In your opinion, which one is the most serious?
2. Could you please kindly tell in detail about the bank's internal credit rating system? In your opinion, is it helpful to ANZ's credit management?
3. Could you please kindly tell about bad debt rate control in ANZ Vietnam? Do you have any policies related to delinquent rate control?
4. Could you please kindly provide map of lending procedure and assessment of ANZ Vietnam?
5. Could you please kindly provide credit risk management structure of ANZ Vietnam
6. Is there any customer categorization? What are the criteria for that categorization? What type of customers is most likely to generate bad debt?

Questions on the bank's performance

1. Did you ever have to loosen credit approval standards due to profit pressure?
2. About credit risk management and bad debt rate control, what is ANZ Vietnam situation and ranking?

Appendix 3

Anti-Money Laundering and Counter-Terrorism Financing Policy (Adapted from ANZ homepage)

Key obligations

Under this policy, ANZ will:

- implement a risk-based preventive approach, using practices that identify, manage and mitigate money laundering and terrorism financing risk
- conduct customer identification and verification activities in proportion to the money laundering and terrorism financing risk posed by that customer
- monitor customers for evidence of suspicious activity, and report such activity where it suspects a person may be acting illegally
- file all reports required by the relevant anti-money laundering regulators
- ensure that third parties acting for ANZ comply with this policy
- retain all records that may be relevant to anti-money laundering and counterterrorism financing activities at ANZ for a minimum of 7 years

Role of Anti-Money Laundering and Counter-Terrorism Financing Compliance Officer

ANZ appoints a senior manager to the statutory role of Anti-Money Laundering and Counter-Terrorism Financing Compliance Officer. The duties of this officer include:

- providing leadership, guidance, advice and direction for the effective operation of, and compliance with, this policy across ANZ
- maintaining the necessary procedures and risk assessment model to support the policy
- maintaining general awareness training on money laundering and terrorism financing
- monitoring anti-money laundering and counter-terrorism financing incidents and rectification activities