Policy of Openness for Foreign Banks in Vietnam

Nguyen Chien Thang[1]

[1] Vietnam Institute of Economics, Viet Nam Academy of Social Sciences.
Email: ncthang69@yahoo.com

Received: 8 June 2017. Accepted: 9 August 2017.

Abstract: Since Vietnam joined the World Trade Organisation (WTO), the country has been implementing an extensive open door policy in the banking sector, allowing 100% foreign-owned banks to be established in Vietnam and encouraging domestic banks to seek foreign strategic investors to raise the capital, improve the technologies and better the risk management. The process has gained positive results, with the rapid increases in the number of 100% foreign-owned and joint-venture banks, and the increasing international competition and cooperation among the banks in the country. However, the increasing penetration of foreign banks in line with the roadmap for openness following free trade agreements signed has been posing a number of challenges for domestic ones, namely the amounting pressure of competition in the sector, the possibility that domestic banks will gradually lose important segments of the market, being acquired and controlled by foreign ones.

Keywords: Banks, policy of openness, Vietnam.

Subject classification: Economics

1. Introduction

Vietnam began its implementation of the openness of banking system in 1990 with the establishment of the first joint-venture bank - the Indovina Bank (a joint venture between the Cathay United Bank of Chinese Taipei and Vietnam joint stock commercial Bank for Industry and Trade - Vietinbank). In 1992, the first branch of a foreign bank was permitted to be established in Vietnam, which is the branch of the ANZ from Australia. From this, the policy for foreign banks has been more and more open in line with the extensive integration progress of Vietnam into the international economy. The policy of openness in the banking sector can be divided into two stages: one before the WTO accession and one since the WTO accession in 2007 to present. The policy has significant positive effects on the banking system in Vietnam. This article analyses the policy of openness for foreign banks and its positive effects.

2. Contents of the policy for of openness for foreign banks in Vietnam

2.1. Before the WTO accession

Before Vietnam joined the WTO, foreign banks had been subject to a number of limitations on the business scope and activities. In line with Decree 13/1999/NĐ-CP dated March 17th 1999 by the Government on the organisation and operation of foreign credit institutions and their representative offices in Vietnam, foreign banks were allowed to operate in Vietnam in 3 forms: branches of foreign banks (with licensed maximum operation period of 20 years and legal capital of 15 million USD), joint-venture banks (with licensed maximum operation period of 30 years and legal capital of 10 million USD), and representative offices (with licensed operation period of 5 years). The 2004 Law on Credit Institution was more open with the permission for wholly foreign-owned banks, or banks with 100% foreign capital, to be established and operated in Vietnam.

As regards capital raising, foreign banks were not allowed to receive savings deposits in any form. They are only allowed to receive time deposits and demand deposits in line with the regulations of the State Bank of Vietnam; specifically, foreign banks were only allowed to receive demand deposits in Vietnamese dong (VND) with the value equivalent to up to 25% of their charter capital from individuals and legal persons who have no credit relation and up to 100% in case of customers who have credit relations. The banks were also permitted to receive time deposits with value equivalent to up to 50% of their charter capital from institutions having credit relations. For credit activities, they were permitted to provide term loans but not allowed to accept the land use right as collateral.

Regarding capital contribution, foreign investors were permitted to contribute not more than 50% of the charter capital of a joint-venture bank; one foreign shareholder was permitted to contribute not more than 10% and the total shares held by foreign investors shall be not more than 30% of the charter capital of a Vietnamese joint stock commercial bank.

It can be seen from the regulations that before Vietnam joined the WTO, the openness in the banking sector was very exiguous.

2.2. Since the WTO accession

After Vietnam joined the WTO in 2007, the country embarked on an extensive policy of openness in the banking sector. In general, Vietnam's commitments in the sector upon the WTO accession allow foreign credit institutions to enter the Vietnamese market in various forms, extending the business scope and types of banking services, and creating a level playing field in the banking sector.

In terms of the presence of foreign credit institutions in Vietnam, according to the country's WTO accession commitments, since 1st April 2007, in addition to the forms of representative offices, branches, and joint-venture banks, foreign credit institutions are permitted to establish banks with 100% foreign capital. However, Vietnam applies the conditions on the total assets of credit institutions which seek to establish commercial presence in the Vietnamese territory. In line with this regulation, the parent banks must have the total assets of more than 20 billion USD at the end of the year prior to the time of requesting to open the branch; joint-venture banks or wholly foreign-owned banks must have the total assets of at least 10 billion USD to be established in Vietnam; the licensed duration of operation was also extended to the maximum of 99 years instead of 20 years as before. Such regulations aim not to restricting the establishment of foreign banks, but to the attraction of large banks to join the market.

Foreign banks may access the market by contributing capital to domestic commercial banks. They are allowed to buy shares of a local joint stock commercial bank provided that the total shares held by foreign individuals and legal persons in a domestic bank shall be not more than 30% of its charter capital, unless otherwise stipulated by the Vietnamese laws or permitted by relevant competent authorities. The cap of the 30% equity is not different from the provisions of Decree 03/1999/NĐ-CP. However, only after the WTO accession could foreign banks buy the shares and become strategic partners of a local bank through this method of market access.

Foreign banks also enjoy the extensive openness in term of the scope of business and types of banking services. Those operating in Vietnam are allowed to provide most of the types of banking services, such as lending, deposit taking, financial leasing, foreign exchange trading, money market instruments, derivative financial instruments, money brokerage, and asset management, provision of payment services, financial advisory and information.

For deposit taking, branches of foreign banks are permitted to receive unlimited deposits in VND from legal persons; the roadmap for loosening the restrictions on deposit taking from Vietnamese individuals was implemented over 5 years: as from 01/01/2007: maximum 650% as of legal capital of a bank; from 01/01/2008: 800%, from 01/01/2009: 900%, from 01/01/2010: 1,000%, and, as from 01/01/2011: national treatment has been fully implemented.

In comparison with some ASEAN countries, the open door policy of Vietnam in the banking sector is quite clear and open on the level and extent of openness. As regards the commercial presence, Vietnam has no regulations of restriction on the investment method. Foreign banks may join the market in various ways ranging from setting up a representative office to the establishment of a wholly foreign-owned bank. Vietnam also has no limitation on the number of branches of a foreign bank to be established. Compared to other countries in the region, Vietnam is fairly open in term of market access. Singapore is the most developed countries in the ASEAN, but it is free of restriction only on representative offices and branches, and foreign banks are not licensed to set up banks with 100% foreign capital. Malaysia has no regulations of prohibition but restricts investment with unclear qualitative conditions. Thailand does not have restrictions on foreign banks but has strict regulations on the maximum number of branches of each foreign bank.

Vietnamese regulations on capital contribution in local banks are tighter than those of other countries in the region. The ceiling of foreign ownership in a local bank is 30%, which is the same as the regulation of Malaysia but lower than those of other countries in the compared group. Indonesia is the country with the highest level of ownership cap of up to 99% of a local bank's shares (the remaining 1% shall be mandatorily owned by Indonesian citizens).

Thailand sets in laws the maximum ownership of not more than 49%, but in some special cases, foreign investors may own 100% of the capital of a local bank.

Regarding exemptions, Scheme No. 254 on “Restructuring credit institutions in the 2011 - 2015 period” allows foreign investors to own 100% of the capital of a local bank. However, the approval of the Prime Minister is required on the case-by-case basis, and practically no cases have so far been approved.

Similar to other countries in the group, Vietnam has conditions of limitation, such as the conditions on the assets of parent banks which seek license for the establishment of 100% foreign-owned banks or branches. In addition, the country has a binding condition which was to gradually loosen the restrictions on capital raising of foreign banks (the binding regulation has expired). Regarding this regulation, Vietnam’s policy is clearer and more transparent in comparison with those of Malaysia and Thailand.

Thus, except for the restrictions on the ceiling level of capital contribution, Vietnam’s policy of openness in the banking sector is quite similar to and even more open than those of the countries in the group. However, in term of commercial presence, the proportion of foreign banks in Vietnam is far lower than that in the other countries.

3. Positive effects of the policy of openness for foreign banks in Vietnam

3.1. Significantly increasing the number of foreign banks

It can be seen that thanks to the commitments of opening-up the banking sector upon the WTO accession, the number of foreign banks joining the Vietnamese market has increased significantly. Before the accession, in Vietnam, there had been only branches of foreign banks and joint venture banks, and no wholly foreign-owned ones. At present, nine such banks have been established in Vietnam, namely the Woori Bank (Korea), Public Bank Berhad (Malaysia), ANZ Vietnam, Hong Leong Vietnam, HSBC Vietnam, Shinhan Vietnam, Standard Chartered Vietnam, CIMB Bank Berhad and the UOB of Singapore. Five wholly foreign-owned banks were licensed in 2008, one year after Vietnam joined the WTO, namely the HSBC (Hong Kong), Standard Chartered Bank (the United Kingdom), ANZ (Australia), Shinhan (South Korea), and Hong Leong (Malaysia), some of which have been operating in Vietnam for a long time, such as the HSBC Vietnam and the Standard Chartered Vietnam. The number of branches of foreign banks has increased from 34 in 2006 to 51 in 2016 (as of June 2016).

As regards joint-venture banks, there had been 5 of them only, but after the WTO accession, in 2008, Shinhanvina bank, which had been a joint-venture with a Korean partner, was changed into a bank with 100% foreign capital (Shinhan bank); in the end of 2015, the Vinasiam Viet Thai, a joint-venture with a Thai partner, also became a foreign bank. As a branch of Siam bank; and lately in April 2016, the joint-venture bank named the VID Public Bank, which is a joint-venture with a Malaysian partner, was also change into a bank with 100% foreign capital (named Public Bank Vietnam). At present, there are only 2 joint-venture banks, namely the Indovina Bank and the Vietnam - Russia Bank.

In addition to the forms of joint-venture banks and wholly foreign-owned banks, foreign banks also access the Vietnamese market via the method of merger and acquisition (M&A), especially since 2007.

This comes from the strategy of utilising the strengths of Vietnamese banks in terms of the existing branches and customer networks. For their part, the Vietnamese banks take advantage of the financial capacities, technologies and management skills of the foreign ones. The proportion of foreign ownership in joint stock commercial banks has been increasing. Right after the opening of the banking sector, state-owned banks started the process of equitisation while the joint stock commercial banks started raising their capital [3]. For commercial banks, the opening-up of the domestic market means an increase in the ownership ratio of foreign investors. Among the group of state-owned joint stock banks, Vietinbank and Vietcombank have the ownership proportion of foreign investors of 28% and 21% respectively. Among the group of joint stock commercial banks, the ownership proportion of foreign investors tends to increase in those with the medium and large scales, such as ACB, EIB, TCB, VIB, VPB (approximately from 20% to 30%). Especially, the ownership proportion of foreign investors in ACB reached the ceiling of 30% during the period of 2012 – 2015. Although An Binh Bank (ABB) was a small bank, given the advisory from the International Financial Corporation (IFC, under the World Bank Group) since 2012, the ownership of foreign investors in the bank increased from 0% to 20% during the year of 2011 – 2012, and to 30% in the 2013 -2015 period. Thanks to the increase in foreign ownership, ABB has proactively restructured itself, leaving the list of weak banks forced to restructure.

3.2. Enhancing the competitiveness of banks

The openness of the banking system has strongly affected the banking market both in the performance quality and the operating environment. In terms of the performance, competitiveness, or, more precisely, the concern of the potential of foreign banking institutions has made local commercial banks proactively adjust and improve their operations and capacities of service provision. Regarding the operating environment, the presence of foreign banks with international standards are the drive for the competent authority (SBV) to apply international standards, such as the Basel standards, on surveillance and supervision, creating a sound and safe environment for banking activities.

Foreign banks normally come from developed countries where the financial banking systems have developed at a high level with orderly operations and scientific and modern management methods. Thus, the operations of their branches in Vietnam also “inherit” the advantages. It can be seen clearly through the types of service provided to customers as well as the quality of services and the attitude of customer service. Therefore, in order to compete with the banks having foreign elements, local commercial banks tend to strengthen their application of modern governance and technology in banking activities. In terms of governance, most of the commercial banks with foreign ownership of more than 5%, e.g. Techcombank or VIB, have step by step applied modern principles of governance for the banking sector. This tendency, along with the urge to find a common ground with foreign investors and partners on the path of cooperation and competiveness, has spilled over into other banks. A large number of local commercial banks have hired foreign aspects to provide packages of advisory focusing on issues which had been underestimated before the WTO accession, such as strategy development, business plans, risk management, personnel management, service quality assessment… Take the Maritime Bank as a typical example: in the period of 2009 - 2010, the bank hire the world-leading consulting firm McKinsey to restructure its operations with the goal to become one of the leading banks both in assets and service quality.

Besides, the improvements in transparency, publicity and governance in the banking sector are resulting in narrowed gaps with international standards. The increase in the foreign ownership proportion in commercial banks means that they need to standardise their governance, accounting and financial activities in line with international practices, ensuring the standards of transparency and publicity. Most of commercial banks, upon listing on the securities market, have to shift their accounting system to the International Financial Reporting Standards (IFRS), in addition to the Vietnamese Accounting System (VAS). It is an indispensable requirement when commercial banks seek to be listed on the international market. A number of major commercial banks hired international valuation and rating firms for their credit rating in order to find opportunities to enter the international market.

Additionally, foreign banks have been the pioneers in applying modern technologies and introducing new products and services. Branches of foreign banks often play the dominant roles in payment services and non-credit activities. Therefore, the application of modern technologies in banking activities has also been enhanced thanks to the impacts of foreign investors. Most of the banks with foreign ownership have applied modern software and technology system for management and improved the quality of services, such as core-banking and customer relationship management (CRM). The pressure for competitiveness in the improvement of service quality has also made IT application more popular in the Vietnamese banking sector.

Commercial banks enhance their competitiveness by improving the service quality and diversifying their products. Because of the decline in the market share and worries of the professional service provided by foreign banks, Vietnamese commercial banks have proactively improved the quality of service and competitiveness. In fact, with the quality and professionalism in services, foreign banks have gradually shown higher advantages in comparison with local banks in attracting middle-class customers who have middle or higher incomes. The sharpening of competitiveness and shifting of the service delivery model from passive to active provision of a package solution to meet the needs of customers have become popular, particularly in the group of joint stock commercial banks, in which Techcombank and the Maritime bank are typical cases.

3.3. Strengthening the cooperation between foreign and local banks

Comparisons drawn between foreign banks and local ones have shown that each of the groups has its own strengths. While foreign banks have the advantage of capital, technologies and management skills, local ones, especially the four state-owned banks, have their nationwide networks. Therefore, on the one hand, they compete against one another on a number of segments, but on the other hand, they tend to cooperate on the basis of complementary strengths to develop together, such as in the tendency of merger and acquisition (M&A), or the cooperation in technology between the two groups, for example, the electronic payment system... Regarding the scope of operation, the foreign group with its advantage focuses on investment banking and specific pools of its customers such as FDI enterprises, medium and high income earners in big cities.

In terms of the investment bank services, foreign banks have outstanding advantages in comparison with local ones thanks to their international reputation and a network available with professional investors. Currently, foreign banks have most of the major customers in the area of arrangements for bond issuance and share trading. For example, in November 2014, HSBC, Standard Chartered Bank and Deutsche Bank jointly arranged the 1 billion USD bond issuance of the Vietnamese Government at a fairly low interest rate. Early in December 2014, the Standard Chartered and the Societe Generale Corporate and Investment bank also assisted the Masan Consumer to successfully issue 10-year bonds for the first time with the value of 2.1 trillion VND, which was guaranteed by the investment and credit guarantee institution under the Asian Development Bank (ADB). Besides, a number of tranches of international bond issuance by major corporations, in the previous years, such as the Vinacomin, Vingroup, BIDV, HAG…, were also managed by the world’s major investment banks operating in Vietnam.

In terms of the retail banking services, with the advantage in financial capacities, experiences, quality of service, as well as being the pioneers in the development and application of modern technologies and new products in the Vietnamese market, e.g. e-banking, foreign banks focus on middle-class customers who have middle and high incomes and reside in big cities.

As foreign banks only focus on investment bank services and specific pools of customers in big cities, they do not make significant impacts on the market share of local banks. They maintained a low proportion of capital mobilisation and credit, which was from 5 to 7% of the total capital mobilisation and total credit amounts. Typically, foreign banks tend to maintain the proportion of capital mobilisation and credit under the threshold of 10%. The fact came from a number of reasons, in terms of scale, local banks have the advantage of their networks; while foreign banks target specific groups of customers, applying high standards of credit, hardly providing credit for high-risk projects. In terms of assets, branches of foreign banks only accounted for 6.92% of the market share (as of 31 December 2014) while banks with 100% foreign capital and joint venture banks occupied approximately 3% and 0.75% respectively of the total market share. Because of only focusing on several services and specific groups of customers, the return on equity (ROE) of foreign banks is lower than those of local ones.

However, in terms of the capital safety, the capital adequacy ratio (CAR) shows that foreign banks rarely involve in high-risk credit activities. Comparison with the group of joint stock commercial banks shows that the CAR in foreign ones is higher, and much higher than the prescribed safety ratio of 9%.

4. Conclusion

According to the roadmap of implementing the commitments in the banking sector under the framework of the ASEAN Economic Community (AEC), Vietnam has to apply the policy of openness to ASEAN banks by increasing the threshold of foreign ownership in local banks from 30% to 70%. In the context of globalization, international financial integration is an indispensable trend, especially in the banking sector which is the transshipment channel of capital flows for the economy. This is concretised in Vietnam's commitments under the Trans-Pacific Partnership Agreement (TPP). In TPP, Vietnam continues its extensive openness in the banking sector, for details, Vietnam undertakes not discriminate between domestic and foreign financial services suppliers, allow foreign ones to cross-border provide financial services in a number of services and financial products, protect foreign investors in financial sector as well as undertakes obligation on transparency… This is the following step of commitments under the WTO accession which cross-border trade was not listed. Meanwhile, new foreign capital flows rooting from TPP create a drive for the SBV to consider extending the foreign ownership threshold in local banks.

However, the increasing penetration of foreign banks following the open-up schedule of free trade agreements will pose three main challenges to the group of local banks. *Firstly*, the deepening participation of foreign banks, especially financial institutions from the United States of America, Japan and Australia will increase the pressure of competitiveness in the sector; the foreign banks, with their advantages of financial capacities and professional management skills, create amounting pressures on local ones. *Secondly*, the "retail" strategy of foreign banks, with the strengths in terms of products and services, technology, customer approaching skills…, may take over key segments of the market from local ones. *Thirdly*, the increase in the foreign ownership threshold, on the one hand, might help domestic banks receive capital from foreign investors, but, on the other hand, they may be taken over and dominated. The scenario that listed companies in the fields of manufacturing and trade have been dominated by foreign investors can be repeated in the banking sector. This is more likely to happen when a clear solution for the issue of cross ownership among Vietnamese banks has not been found.

To cope with the challenges, the SBV implemented Scheme 254 entitled "Restructuring the banking sector in the 2011 - 2015 period". The scheme set the goals of fundamentally, thoroughly and comprehensively restructuring the system of credit institutions in order to develop a system of modern multifunctional credit institutions with safe and sustainably efficient performance, diverse forms of ownership, scales, types, and greater competitiveness based on advanced banking governance and technologies that are conformed with international standards, for the purpose of better satisfying the demands for banking and financial services of the economy. One of the key highlights in the scheme was that foreign investors were permitted to own 100% (of the) capital of a local bank (applicable for weak banks with the need of new funds); modern surveillance and control tools were also developed, which enabled the SBV to adjust and lay more efficient impacts on the banking operations. The SBV is developing a plan following Scheme 254 for the 2015 - 2020 period in order to strengthen the process of restructuring the system of credit institutions and improvement of the handling of bad debts. Basically, this is the premise for domestic banks to maintain their competitiveness against foreign banks.

It can be said that Vietnam's policy in the banking sector is fairly open in terms of the level and extent of openness. In general, the open policy in the banking sector after the WTO accession has had positive effects. Vietnam has had significant improvements in the business environment of the banking sector in line with international standards; the performance of local commercial banks has been improved as well. However, the penetration of foreign banks in line with the opening-up roadmaps of free trade agreements signed in the up coming period will pose some challenges for the domestic banks. Vietnam needs to be well-prepared to cope with these challenges.

References

[2] Dự án hỗ trợ thương mại đa biên (MUTRAP) (2006), *Nghiên cứu tác động của tự do hoá dịch vụ ngân hàng đối với cạnh tranh trong lĩnh vực ngân hàng*, Hà Nội. [Multilateral trade assistance project (MUTRAP) (2006), *Research on Effects of Banking Liberalisation on Competion in Banking Sector*, Hanoi].

[3] Tao N. (2008), "Những thành công bước đầu của ngân hàng Việt Nam sau một năm gia nhập WTO", Tạp chí *Quản lý Kinh tế*, số 18. [Tao N. (2008), "Initial Successes of Vietnamese Banks After one Year of the WTO Accession", *The Economic Management Review*, No. 18].

[4] Thanh N. (2016), *Tác động của Hiệp định Đối tác Kinh tế Chiến lược Xuyên Thái Bình Dương (TPP) đến ngành ngân hàng Việt Nam*, Viện Chiến lược ngân hàng, Hà Nội. [Thanh N. (2016), *Impacts of Trans-Pacific Partnership Agreement (TPP) on Banking Sector in Vietnam*, Banking Strategy Institute, Hanoi].

[5] Moreno, R. and Villar, A. (2005), *The Increased Role of Foreign Bank Entry in Emerging Markets*, BIS, p.23.

[6] Nepru (1998), *Namibia: Financial Services and the GATS*, CAPAS Report.

[7] Schulz, H. (2006), *Foreign Banks in Mexico: New Conquistadors or Agents of Change?*, University of Pennsylvania.

[8] Stichele, M. (2004), *Critical Issues in the Financial Sector*, Center for Research on Multinational Corporations.

[9] http://www.iflr.com/Article/2923753/Foreign-banks-to-increase-their-presence-in-Thailand.html

[10] http://www.thejakartapost.com/news/2012/08/28/foreign-banks-vs-domestic-banks.html