Chapter 9

Vietnam’s Capital Markets: Young and Growing

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Abstract:

Vietnam’s financial markets have extended rapidly with an over dependence on credit of the banking sector in the last decade. In order to secure sufficient stable and long-term capital for a sustainable development, the Government has put considerable efforts to develop the capital markets. However, Vietnam capital markets-though growing fast- are still at an early stage of development and facing lots of challenges. This chapter reviews recent developments and challenging issues of Vietnam’s capital markets and then introduces the latest Government’s strategy that includes international financial cooperation with other advanced neighbors for further sound developments of the markets.

Keywords:

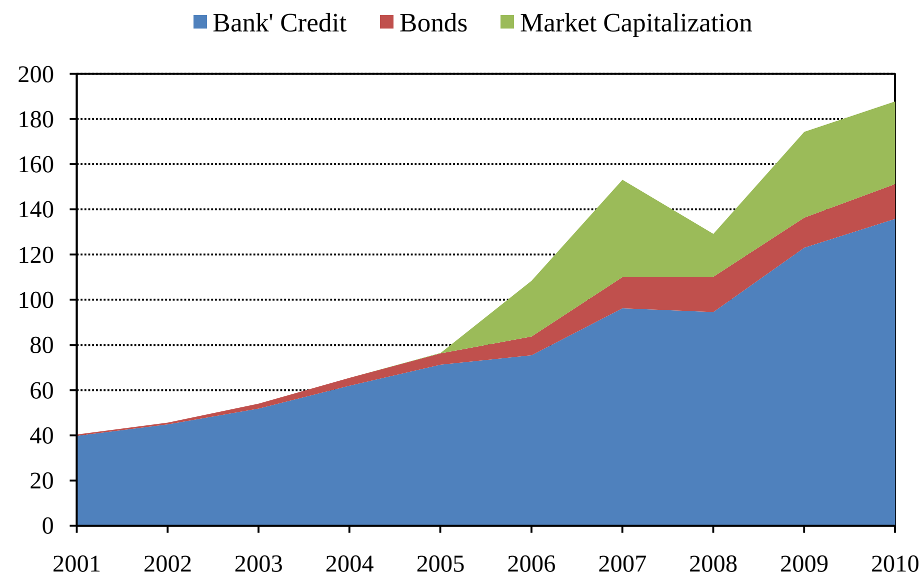
young, volatile, short-term, un-transparent, growing

Introduction

Vietnam's financial markets have extended aggressively in the last decade. However, like many other East Asian economies, Vietnam has relied heavily on banking lending (Figure 1) and by end-2010 total banking credit in Vietnam has reached 135 percent of GDP, which are about 4 times the value of share market capitalization and 10 times the total value of the bond market. As often discussed in the literature, an unbalanced development of the financial markets with over-dependence on banking credit poses a great risk for the stability of the overall financial system and economic development due to mismatch problems. Moreover, it has been estimated by the Eurocham that for the next 5-10 years, Vietnam will need about US 120 billion dollars to finance its infrastructure projects for a sustainable growth. This amount of capital is beyond the capacity of Vietnam's government budget finance. Moreover, because infrastructure investment projects require stable and long-term capital, the development of capital markets, in particular the bond market is very crucial for the Vietnam's economic development in the next period.

However, the capital market in Vietnam is still very young and at a very early stage of development in a transition developing economy. Therefore, international financial cooperation will be very important because it might not only help Vietnam access more capital from neighboring regions but also speed-up the development and formulation of its domestic capital market system. With this stance, the chapter will start by reviewing the development of Vietnam's capital market with a focus on the bond market in the last decade. It then examines the current situations and challenging issues of the capital market, and introduces the latest strategy of Vietnam's government for the development of capital market. Concluding remarks concludes the chapter.

Figure 1 Bank credit lending, market capitalization and bond markets (%GDP)



Source: Thomson Reuter, Asian Bonds Online, HNX .

1. Development of Capital Markets

1.1 Equity Market

Table 1 summarizes recent development of Vietnam's capital markets. Although the history of the capital market in Vietnam, a transition developing economy, may be dated back to 1990 when the First Law on Companies and Private Enterprises was passed and state-owned enterprises were first equitized, the capital market actually became operational in 2000 when Ho Chi Minh Stock Trading Center (later upgraded to Ho Chi Minh Stock Exchange: HOSE) was opened with 7 licensed securities companies.[1] After just more than 10 years of operation, despite lots of great volatility, the capital market in Vietnam has

[1] It is thought that Vietnam's capital markets only became "full-operational" only after important legal framework such as Law on Securities and Law on Enterprise became effective in 2006.

thrived significantly. In 2011, there are more than 500 listed companies on the two stock exchanges with total share market capitalization of about 30 percent of GDP. The value of the bond market has also reached more than 15 percent of GDP from a negligible level. There are currently more than 730,000 trading account with 102 securities companies. [2]

There have been also significant improvements in the legal framework, supervision system and regime regarding to the capital markets in Vietnam and table 2 summarizes the current supervising system. Although regulations may be sometimes still unclear and different market intermediaries and authorities may interpret regulations differently, overall, the market is consistently moving towards international standards.

Moreover, although Vietnam's capital market is still pretty behind its ASEAN advanced neighbors such as Singapore and Thailand, it has potentials and appears promising. As shown in Figure 2, the number of listed companies comprises still only 16 percent of total already equitized companies in Vietnam and some of un-listed companies are very large in terms of scale and attractive profitability. The process of privatization of many large State-owned enterprises (SOEs) has been delayed due to recent downturn of the stock market but will be implemented when the market recovers.

[2] Till 2011, there are 102 securities companies in which 19 are foreign invested and foreign firms must establish a joint-venture company with Vietnamese partners and apply for a license with SSC to conduct securities trading activities in Viet Nam. However, from 2012, 100 percent foreign owned securities companies will be licensed in Vietnam due to WTO undertakings.

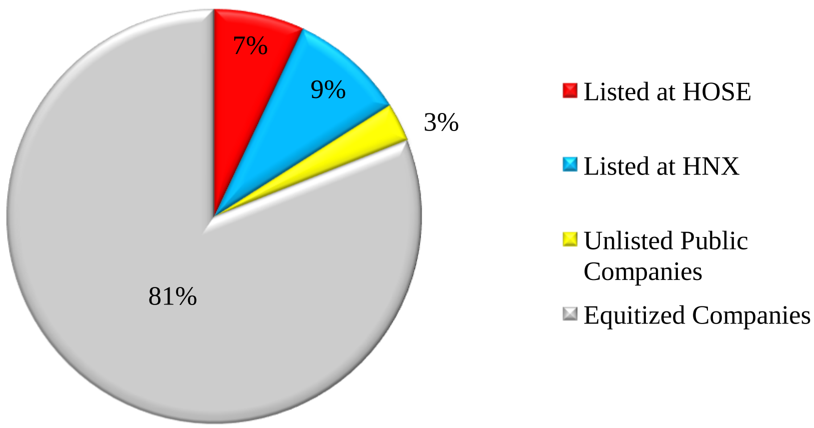
Table 1 Development of Vietnam’s Capital Markets

Time	Development of Institutions and Legal Framework
1990	Law on Companies and Private Enterprises 1990 was passed
1992	SOEs' Equitization Started
1996	State Securities Commission (SSC) was established
2000	July: Ho Chi Minh Stock Trading Center (HoSTC) was opened December: 7 Securities Companies were licensed
2003	Government Decree 144 on Securities Market and Securities Companies
2005	The Enterprise Law, 2005 Hanoi Stock Trading Center (Hanoi STC) was opened
2006	Vietnam Securities Depository was established
2007	January: The Law on Securities 2006 became effective August: HoSTC was upgraded to Ho Chi Minh Stock Exchange (HOSE)
2009	Hanoi STC was ungraded to Hanoi Stock Exchange (HNX) Unlisted Public Companies Market was established at HNX Specialized Government Bond Market was opened at HNX
2010	Listed Companies: 488, HOSE (217), HNX (271), Market Capitalization: 30% GDP Bond Market: 15.4% GDP Securities Companies: 102, Transaction Account: ~730,000

Table 2 Vietnam’s Financial Market Supervision System

	Supervising Authorities	Legal Framework
Securities Market, Securities Companies, Stock Exchange	State Securities Committee (SSC)	Law on Securities
Insurance Market	Insurance Supervision Department (Ministry of Finance, MoF)	MoF's Decision 288/2009
Bonds Market (Corporate Bond Issuance)	Banks and Financial Institutions Department (MoF)	MoF's Decision 2456/2009
Banks and other Credit Institutions	State Bank of Vietnam (SBV)	Law on Credit Institutions
Overall Financial Markets	National Financial Supervisory Commission	Prime Minister's Decision 34/2008

Figure 2: Composition of Public Companies in Vietnam



Source: HNX.

1.2 Bond Markets

Vietnam's bond markets comprise Treasury bonds and bills, government-guaranteed bonds, municipal bonds,[3] State Bank of Vietnam bills, and corporate bonds. The first three types of bonds are usually called Government bonds that are defined and regulated by Decree. No. 141/2003/ND-CP comprise for more than 90 percent of Vietnam's total outstanding bond value. Among Government bonds, the so-called government-guaranteed bonds are issued by the Vietnam Development Bank (VDB), the Vietnam Bank for Social Policies (VBSP) and some others assigned SOEs to mobilize capital for government's socio-economic investment projects under the direction of Prime Minister, with due payment by the issuers is committed by the Government with investors.

Meanwhile, Law on Securities 2006 and Decree No. 52/2006/ ND-CP (recently replaced by Decree No. 90/2011/ND-CP) provide important legal framework for SOEs and private enterprises to issue corporate bonds. As a result, Vietnam's corporate bond market, though still very thin, appeared and started growing rapidly since 2007.

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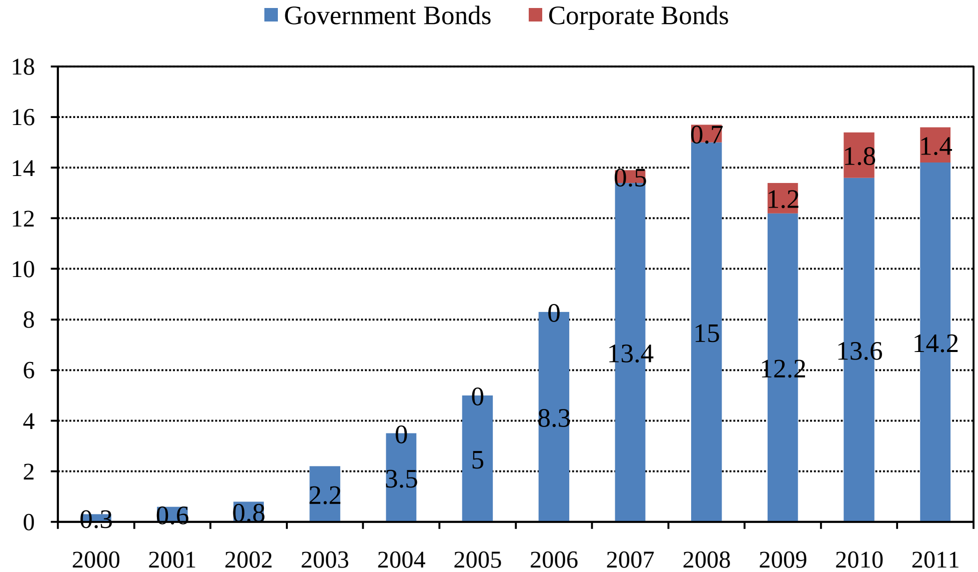
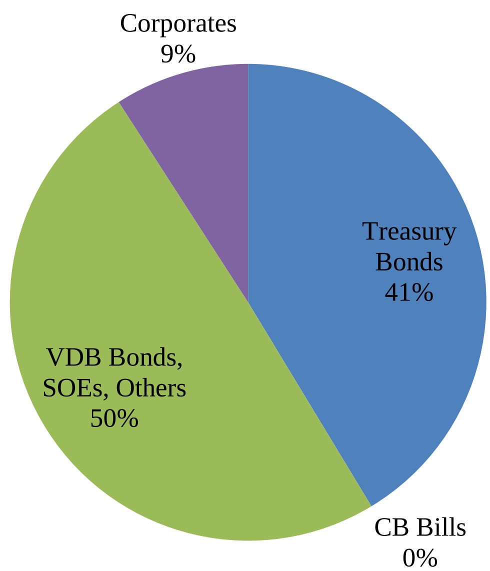
[3] Municipal bonds in Vietnam are issued by provincial people's committees. Currently there are municipal bonds issued by Hanoi, Ho Chi Minh, and Dong Nai.

Figure 3 Vietnam's Bond Market since 2000 (%GDP)



Source: Asian Bonds Online.

Figure 4: Composition of Vietnam' Bond Market (end 2011)



Source: Asian Bonds Online.

1.2.1 Government Bonds

Currently, Vietnam's Government bonds are issued and distributed only by underwriting and biddings then listed and traded at Hanoi Stock Exchange (HNX).[4] Although the total value of outstanding Government bonds is just about 14 percent of GDP, which is still pretty small compared to other neighboring ASEAN economies, there are more than 500 bond issues with various maturity, terms, and sizes. Consequently, an average size of a bond issue is usually less than US 20 million dollars. In addition, because of highly turbulent macro economy environment and recent monetary policy tightening, the number of investor participating in government bonds bidding and the success rate in bidding in general declined[5]. Figure 6 shows that the amount of long-term bonds (longer than 10 years) has also decreased and the average duration of Vietnam's government bonds is around 3.5 years, which are relatively shorter than that in other ASEAN economies.

Moreover, government bonds that are issued under underwriting are mostly held still by large domestic commercial banks without further distribution to the secondary market. Currently, Vietnam's four largest state owned or formerly state owned commercial banks, BIDV, AGRIBANK, VIETCOMBANK, and VIETINBANK are holding up to around 65 percent of the total value of government bonds.[6] Since these large commercial banks often hold government bonds for long-term investment, reserve requirements, and also for liquidity management purposes[7], they tend hold these bonds until maturity. As a result, the liquidity of the secondary market of Vietnam's government bonds has remained very low.

[4] Until 2007, State Treasury also issued Treasury bonds by retailing.

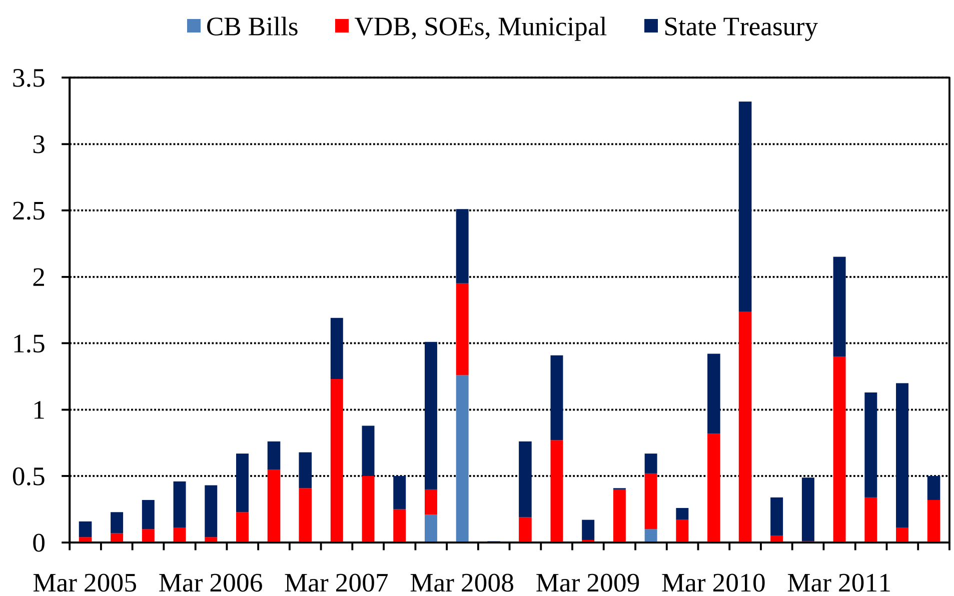
[5] Sometimes, there are only one or two investors participating in bidding while there are about 90 financial institutions that are registered and eligible for bidding. One of the reasons for low participation and success rates is that the Ministry of Finance sometimes sets inappropriate ceiling interest rates in bidding.

[6] According to an interview with an official at HNX.

[7] Under Vietnam's monetary policy regime, commercial banks can use government bonds as collateral to borrow/refinance from the central bank via OMO, discount window and refinancing channels at attractive interest rates.

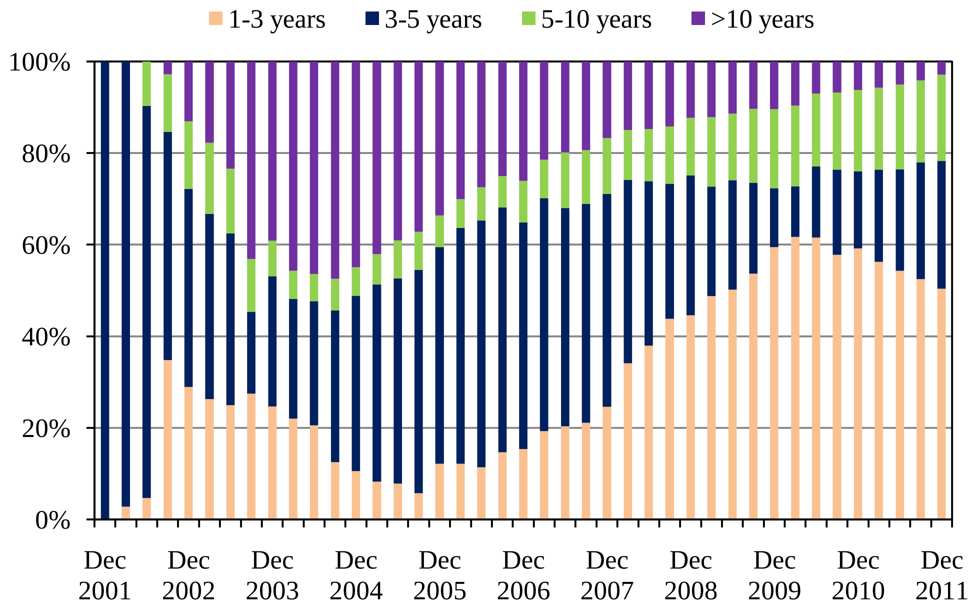
At end-2011, although there are around 500 listed bond issues at HNX, the number of daily bond issue transactions is often less than 10 and the listing scale of each bond code/issue is also very low. Meanwhile, the investor base for the government bonds market is also small; the market also lacks of established market makers and professional and institutional investors. Furthermore, while equities trading can be executed by both automated order-matching system and negotiation (put-through) most bonds trading is conducted through negotiation among brokers.

Figure 5 Government Bonds Issuance (Bill. USD)



Source: Asian Bonds Online.

Figure 6: Government Bonds Maturity Structure



Source: Asian Bonds Online.

1.2.2 Corporate Bonds

Until 2006 corporate bonds issuance in Vietnam was very rare and only limited to large financial institutions because the legal framework, Decree No. 120/1994/ ND-CP that governs and regulates equities and bonds issuance of SOEs was relatively strict. However, after the Law on Enterprise and Law on Securities became effective in 2006[8], corporate bonds issuance has become active and growing rapidly. Notably, post-2006, corporate bonds issuance in Vietnam is not limited to SOEs, including State-owned commercial banks, but also extended to private and foreign companies that often offer interest rate premium. Meanwhile, because of the need of raising capital to meet required Capital

[8] More importantly, Decree No. 52/2006/ND-CP on corporate bonds issuance.

Adequacy Ratio and minimum capital level by financial regulators, convertible corporate bonds issued by commercial banks have been also growing. [9]

However, most corporate bonds in Vietnam are issued in the form of private placement and the issuance procedures are simple. Under current regulations, issuers don't need to register and obtain permission prior to the actual issuance and are only required to report to the Ministry of Finance within 15 days after the issuance.[10] Intermediaries in the primary market of corporate bonds have been significantly extended to not only securities companies but also to commercial banks, especially to well-established foreign financial institutions such as HSBC, ANZ, and Citibank.

Although the corporate bonds market in Vietnam is promising and growing fast, the market scale is still pretty thin and faces many challenging issues for further sustainable development. First, most issuances are under the form of private placement[11] while there are still lacks of regulations and supporting mechanism that encourages or even forces information disclosure and transparency. Consequently, it is very difficult for (potential) investors to obtain reasonable information about the corporate bond market in general or size, maturity, and yield of any specific issue. Secondly, there are still no domestic credit rating companies in Vietnam; hence most of corporate bonds are unrated and their liquidity in the secondary market is very low. Like government bonds, issued corporate bonds are usually held by investors who bought in the primary market until maturity. Thirdly, corporate bonds issuance has been also significantly affected by recent macroeconomic turbulence and tightening monetary policy.

Since it is difficult to obtain official data on corporate bonds, particularly for those issued in the form of private placement we have to rely on sources from some consulting

[9] A distinguish characteristic of convertible corporate bonds in Vietnam is that the maturity is very short; it is often less than 2 years compared to 5-10 years of international standards.

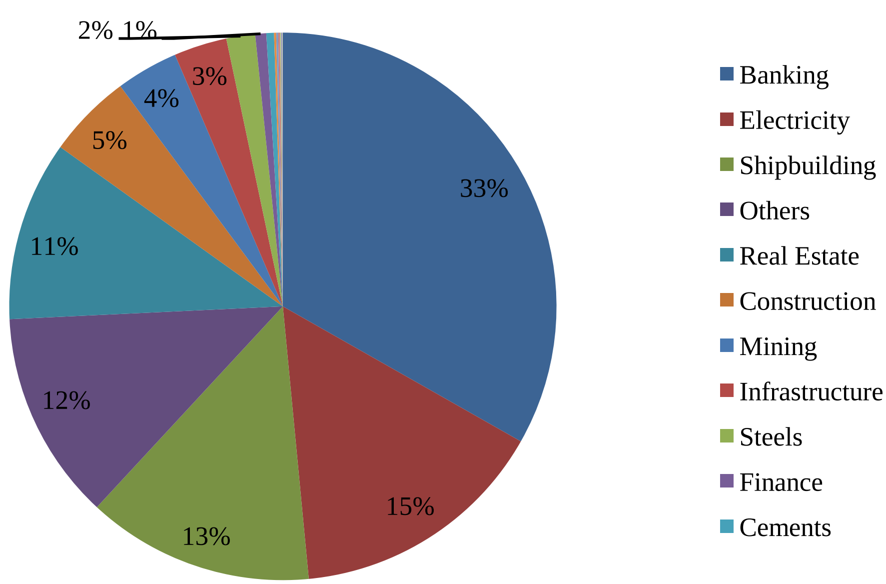
[10] However, according to an official from the Ministry of Finance, many corporate issuers have not reported to Ministry of Finance because of the lack of guidelines (circulars) including punitive measure in dealing with regulation breaching and also the volume of corporate bonds are still relatively small.

[11] Currently (end of 2011) there are only 11 issues of corporate bond s listed on Exchange Stocks.

and advisory financial companies. According to a research paper by Vuong and Tran (2010) that collect data set on 113 successful issuances (out of 152 issuance plans) from 63 issuers. The total successful value of these corporate bonds issuance is around US 4927.47 million dollars. And the data set cover over the period from 1992 until the end of 2009.

The data shows that the value of corporate bonds issued by the financial sector (banks) is the highest, followed by the utility sector (electricity, etc) and then by the infrastructure sector. It is also shown that SOES have a higher of rate of success in issuing bonds than their private counterparts. However, since this data set cover issuances for a long historical period of 1992-2009 it may show a different result from current corporate bond market situations. In particular, according to data from Asian Bond Online, as of September 2011, the top 15 corporate issuers in Vietnam that comprises 95.3 percent of all corporate bonds outstanding are mainly commercial banks (7 out 15) and real estate developers (4 out 15) and around 70 percent of them are listed. Moreover, non-SOEs also dominate (former) SOEs in issuing corporate bonds according to Asian Online Bond.

Figure 7 Issuers of Corporate Bonds by Industry



Source: Vuong and Tran [2010].

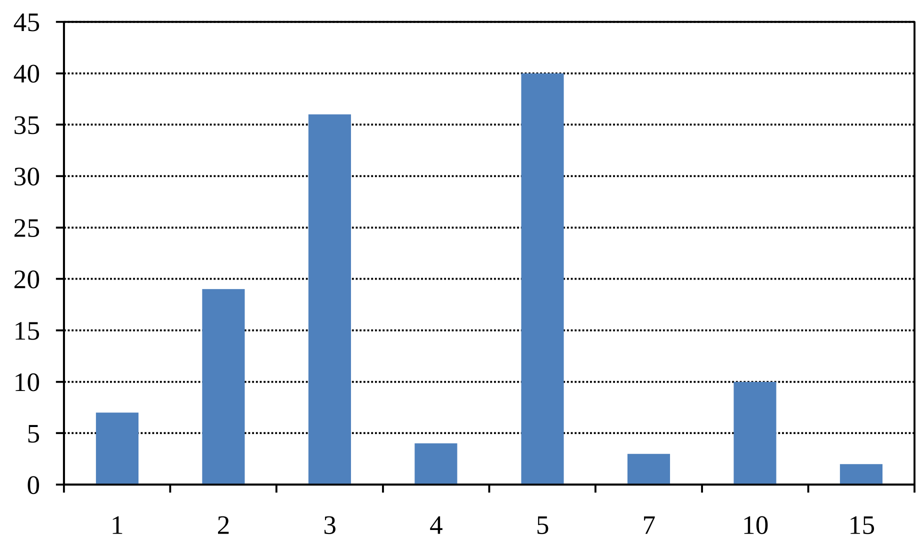
Table 3 Corporate Bonds' Statistics

	Total	State-ownership	Listed
Issuer	63	31 (49%)	22 (35%)
Issuance	152	82 (54%)	46 (30%)
Success	113	69 (61%)	30 (27%)
Value (bil. USD)	4.93	3.14 (64%)	1.14 (23%)

Source: Vuong and Tran [2010].

Back to Vuong and Tran [2010], the maturity of issued corporate bonds collected by their data set is in general relatively short; the most frequent maturity is 5 years, followed by those with 3 years.

Figure 8 Frequency of Maturity



Source: Vuong and Tran [2010].

1.2.3 Foreign Currency Bonds

Foreign currency bonds issuance was long-prepared for Vietnam since 1994 (after the Decree No. 23/1994/ND-CP). However, there were not any actual issuances until the Decision No. 914/2005/ QD-TTg in 2005 and on September 1, 2005 the first foreign currency sovereign bond issuance with total value of US 750 million dollar on the New York Stock Exchange. In 2009, foreign currency sovereign bonds were issued in Vietnam with the value of around US 470 million dollars. However, due to recent macroeconomic turbulence and rising sovereign debts, sovereign ratings and outlook for Vietnam by major credit rating institutions has deteriorated, hence foreign currency sovereign bonds issuances has become stagnant.

Meanwhile, following the foreign currency issuance of sovereign bonds, several large and promising private companies in Vietnam such as Vincom JSC and HAGL have also attempted to access and raise capital from the domestic and international financial market. However, they have been also significantly affected by recent downgrades of Vietnam's sovereign credit ratings (Table 4).

Table 4: Selected Sovereign Ratings and Outlook for Vietnam

	Moody's	S&P	Fitch
Sovereign FCY Long-term Rating	**B1**	**BB-**	**B+**
Outlook	**Negative**	**Negative**	**Negative**

Source: Asian Bonds Online as of September, 2011.

2. Strategy for Development of Vietnam's Securities Market till 2020

2.1 Overall Targets

At beginning of 2012, Vietnam's Prime Minister approved the strategy for development of securities market in the period 2011-2012 (Decision No. 252/QD-TTg). The key points are as follows:

For the overall securities market, the strategy specifies targets,

- To endeavor the total value of share market capitalization is around 70% GDP by 2020; and the bond market becomes an important channel for raising and allocating capital for economic development
- To restructure the organization of the securities market by having only one unified Stock Exchange for the economy and step by step equitizing this Stock Exchange to ensure operational uniformity and managerial capacity improvement in order to attract capital from market members.

More specifically for the bond market, the strategy aims to complete and develop the market on the basis of linking the primary offering market with the secondary trading market; and gradually formulate a benchmark yield rate curve. In particular,

- To complete legal guidelines for the Law on Public Debt Management to control borrowing and repayment; to ensure public debt management in a transparent and well-planned manner.
- To complete methods and forms for issuing government bonds with appropriate terms and maturity; and to formulate a schedule for issuing Government bonds in large lots consistent with the capital raising need of the Government
- To develop a system of primary bond investor base and to create a mechanism that links the primary bond market investors with the secondary bond market investors and gradually forming market makers for the bond market.

- To formulate institution investors such as insurance and pension funds so that they become the main players of the securities market, hence reducing the investment share of commercial banks

The strategy also targets to develop the corporate bond market on the basis of:

- Implementing a regime that issues a registering certificate of an issue prior to the actual issue of corporate bonds and gradually reach the stage of registering an issue with full disclosure of information
- Diversifying bonds types such as assets backed bonds, payment guaranteed bonds, convertible bonds, and gradually formulate the professional activity of assets securitization
- Developing credit rating institutions, first and foremost share-holding credit rating institutions with contributing capital from well-established foreign credit rating institutions

2.2 International Financial Cooperation

Finally, the strategy also sets targets in increasing international cooperation in the securities market with an emphasis the ASEAN region. In particular,

- Strengthening international cooperation with an aim to assist policy formulation, to improve market management and human capital training and also information sharing in order to deal with cross-border law breaching
- Formulating policies and regulations with an aim to commence implementation of WTO commitments and undertakings on accession to capital markets in ASEAN, ASEAN+3, ASEAN+6, and to ensure that there is publicity, transparency and equality between domestic investors and foreign investors
- Implementing programs on bilateral cooperation with other administrative authorities on the basis of signed Memoranda of Understanding, and participating

in other memoranda in the International Organization of Securities Commissions (IOSCO) framework when the Vietnam' State Securities Commission satisfies the stipulated conditions

- Modernizing infrastructure and diversifying trading methods and products of the Vietnam' Stock Exchange and Securities Depository Center; and step by step interconnect with other ASEAN Stock Exchanges and Securities Depository Centers.

Concluding Remarks

This chapter begins by review recent developments of Vietnam's financial markets. It shows that although the financial markets have extended rapidly and the Government has put efforts into developing capital markets, Vietnam's finance is over-dependent on banking credit and the capital markets-though growing fast- are still at an early stage of development with lots of challenging issues. However, in the latest revised strategy for the development of the capital market, Vietnam's Government appears to be active and positive in international financial cooperation, which may help Vietnam resolve some of its challenging issues.

Annex: Vietnam's Bond Market Assessment[12]

Potential barrier area	Current situation	Overall barrier assessment
Quotas	Foreign ownership limits on equities (49% for corporations, 30% for banks) but not on bonds unless the issuer chooses to set a limit. Viewed as open to foreign investors.	OK
Investor registration	Foreign investors need to obtain a trading code, which is granted within 1-2 weeks of validly completed applications. The documentation requirements were previously onerous and for certain types of entities were not clear. However, the requirements have been simplified under new regulations issued in December 2008.	LOW
FX controls - conversion	Foreign investors are allowed to convert FCY to VND in order to trade on the Hanoi and Ho Chi Minh exchanges. The rate must be within a trading band of ±1% (since 2011) of the official exchange rate fixed by the SBV on a daily basis (previously 3%). Foreign investors are only able to execute FX transactions for same-day, next day, or spot value. FCY forwards cannot be sold to foreign investors. Third-party FX is possible, but uncommon. There are no clearly defined procedures or documentation requirements, and as a single payment system does not exist, third-party FX may be problematic.	LOW
FX controls - repatriation of funds	Sales proceeds, dividends and interest may be freely repatriated, subject to tax certification. However, the FX market can be highly illiquid. This is of major concern to investors. "Because VND constantly trades at upper end of trading band, FX requests are placed in a queue that may take ages to be considered." "The way that capital controls work in Viet Nam also causes problems - last year, the rate bands were not adjusted and the central bank would not sell USD at the unadjusted rates, so the market dried up."	HIGH
Cash control credit balances	There are no restrictions on foreign investors maintaining credit balances in VND, or in investing surplus cash balances in interest-bearing accounts or money market instruments.	OK
Cash controls - overdrafts	Foreign investors are not allowed to overdraw their cash accounts. Pre-funding is required for all securities trades. Securities companies only accept its customers order if they have enough securities and money in their account. This regulation is intended to prevent the possibility of default.	HIGH

[12] This section was based on the ABMI Group of Experts Report for Harmonization of ASEAN Bond Initiative Forum. The author updates recent information and changes in the regulations and policy of Vietnam' Bond Markets.

Taxes	Foreign investors are taxed at the rate of 0.1% on the gross proceeds of all sale transactions of taxable bonds (i.e. principal as well as gain). Interest income received from taxable bonds is subject to a tax of 0.1% calculated on the par value (i.e. the principal amount of the bond) plus the interest amount. Effectively, all bonds are taxable. While 0.1% is relatively small, the fact that it is applied to the principal on sale of bonds discourages trading. Investors view the tax system as being complex, but this may reflect the unfamiliar rules rather than inherent complexity. There is no provision for relief at source or for reclaims.	HIGH
Omnibus accounts	Omnibus accounts are allowed. Global custodians and ICSDs can operate omnibus accounts provided the custodian / ICSD registers as an investor. However, there is no nominee concept in Vietnamese law.	OK
Settlement cycle	The settlement cycle for bonds is T+1. Market participants have commented that it is possible for trades to be repudiated as, in law; a trade is not valid until it has been input into the Hanoi exchange system.	LOW
Message formats	SWIFT message formats are not currently used by the CSD or by local market participants.	LOW
Securities numbering	ISIN codes are not currently used by the CSD or by local market participants.VSD is in the process of allocating ISIN codes for Vietnamese securities. However, ISIN codes are not available until the bonds are registered at VSD.	HIGH
Matching	There is a trade matching system but not a settlement matching system for bonds.	LOW
Dematerialization	All bonds are now issued in dematerialized form. Existing issues must be deposited into the VSD (and dematerialized) if they are to be traded.	OK
Regulatory framework	Regulations may be unclear. Different market intermediaries may interpret regulations differently. However, overall, the market is consistently moving towards international standards.	LOW

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Ho Chi Minh Stock Exchange: http://www.hsx.vn/hsx_en/default.aspx

Vietnam's State Securities Commission: http://www.ssc.gov.vn/portal/page/portal/ssc_en