Vietnam Launches Asset Management Company to Tackle Non-performing Loans

A comprehensive restructuring of Vietnam's banking sector is high on the list of government priorities to put the economy back on track. A key problem in Vietnam's banking sector is the high rate of non-performing loans (NPL), which exceeds 10 percent of the credit portfolio of commercial banks according to some estimates. The ratio of new loans that are NPLs, as well as those in the real estate sector, is particularly high.

Managing NPLs: Decree 53

Though Vietnam has an existing state-owned asset management company to handle distressed debts, discussions have been underway for some time regarding the creation of a separate asset management company to exclusively handle NPLs in the banking sector. On 18 May 2013, the government issued Decree No. 53/2013/ND-CP on the establishment, organisation and operation of Vietnam Asset Management Company (VAMC) which came into effect on 9 July 2013 (Decree 53).

The establishment of VAMC is designed to alleviate the burden that NPLs have placed on the balance sheet of Vietnamese commercial banks and other credit institutions. The basic structure will entail VAMC purchasing the debt from the credit institutions and assuming the position of the lender with respect to rights to enforce security, and authority to negotiate interest forgiveness, forbearances, and restructurings (including debt-for-equity swaps). VAMC will ultimately have the power to sell the collateral as if it were the lender of record without the need to amend or novate existing security documentation. The role of foreign investors as potential purchasers of the collateral is a key question that remains unanswered.

VAMC can fund purchases of NPLs either by (1) issuing interest-free bonds with tenors up to five years in a face amount equal to the book value of the NPLs (Special Bonds), or (2) purchasing the NPLs for cash at market value of the NPLs.

In the short-term at least, issuance of Special Bonds is likely to be the preferred source of funding by VAMC. Under this funding method, VAMC acts more as a warehousing vehicle than an actual purchaser since the bonds are sold back to VAMC after five years at a resale price inversely proportionate to the amount of VAMC's recovery on the NPLs.

The second option under which VAMC may purchase NPLs for cash at market value of the NPL in a "true sale" would likely require that VAMC partner with a funding source – whether a private sector investor or a foreign government or developmental finance institution.

(A) ESTABLISHMENT OF VAMC

VAMC is a 100 percent state-owned one-member limited liability company established by the State Bank of Vietnam (SBV). VAMC will have paid-up capital of VND500 billion (approximately US$23 million) and is subject to state management, inspection and monitoring conducted by the SBV.

(B) WHAT IS AN NPL?

VAMC's core business activity will be purchasing NPLs from Vietnamese credit institutions. Interestingly, Decree 53 does not define NPLs or bad debts. VAMC will only buy NPLs which satisfy certain conditions, however, namely those arising from lending or the purchase of bonds and other activities prescribed by SBV and those extended to a borrower that still exists. Even if the NPLs do not meet the above conditions, the Prime Minister may authorise the purchase of such NPLs at the request of the SBV.

(C) MANDATORY PARTICIPATION OF CREDIT INSTITUTIONS

Credit institutions with an NPL ratio of less than 3 percent may sell their NPLs to VAMC, while those with NPL ratios of 3 percent or more are required to sell NPLs to VAMC. Failure to comply with this requirement will subject the credit institution to an external audit or independent valuer reassessing the quality and value of its assets, equity capital and charter capital. Based on the result of the audit and valuation, the credit institution may be required to sell NPLs to VAMC until its NPL ratio reaches a safe level, or otherwise restructure according to a plan approved by the SBV.

(D) METHODS OF PURCHASING NPLS

There are two methods that VAMC may use to purchase NPLs: by issuance of Special Bonds at the book value of the NPLs, or by cash at market value of the NPLs. VAMC has announced its intention to fund the purchase of NPLs through issuance of Special Bonds which may be driven in part by the lack of regulations to determine how cash purchases of NPLs would be made.

(1) Issuance of Special Bonds

Vietnam Dong denominated Special Bonds issued to purchase NPLs may be issued in book-entry, certificated, or electronic form for a maximum tenor of five years, bearing zero percent interest. The credit institutions which purchase the bonds may use them as collateral for refinancing from the SBV (the interest rate and refinancing amount will be determined by the SBV). Credit institutions purchasing Special Bonds are required to establish operational risk provisions at no less than 20 percent of the par value of the bonds.

(2) Cash purchases

In addition to the general conditions applicable to the purchase of NPLs, VAMC must be able to fully recover money used to buy NPLs, the collateral securing the NPLs must be of a nature that can be sold, and the borrower must appear able to restore its debt repayments. There are some key pieces missing as to how this would work, namely the valuation metrics that VAMC would use to determine market value and the source of funding.

(E) VAMC AND RESTRUCTURING

VAMC is given broad powers with respect to its ability to restructure NPLs and service the NPLs. It is authorised to step into the position of the secured party without the borrower's consent or having to execute new security documentation; it can also put borrowers on notice as to the default status of their obligations, negotiate interest forgiveness, extension of repayment dates, and even perform debt-for-equity swaps (though how VAMC would manage an equity position is not currently addressed). VAMC is expressly authorised to take enforcement actions vis-à-vis borrowers as well, as it may submit a bankruptcy petition with respect to a borrower in accordance with Vietnamese bankruptcy law and may sue the borrower for recovery of the loan balance.

(F) VAMC AND SECURITY ENFORCEMENT

In the event that VAMC elects to dispose of the underlying collateral securing the NPL, the underlying security agreement will determine the process. If there are no provisions on point in the security agreement, the collateral will be disposed of through an auction. VAMC may auction collateral without the consent of the securing party, though it must notify the securing party in writing at least 10 working days before the auction. The general provisions of Vietnamese law on secured transactions apply to the disposition of collateral. This implies that any surplus from the sale of the collateral would be returned to the borrower.

It is not clear whether foreigners would be entitled to participate in collateral sales, though this may add significant liquidity to the sale process. A large proportion of NPLs bought by VAMC will likely be secured by real property assets given the high levels of NPLs in the real estate sector. In light of the limitations on foreigners' ability to purchase real estate in Vietnam, the ability of foreign investors to participate in collateral sales will be limited in the absence of special legislation.

(G) REPURCHASE OF SPECIAL BONDS

Within five days of either the maturity date of the Special Bonds or the date on which the full book value of the NPL is set aside under risk provisions, credit institutions holding Special Bonds are required to resell them to VAMC. While not explicitly addressed in Decree 53, this implies that the credit institutions would either need to repay or refinance with different collateral the funds borrowed from the SBV secured by the Special Bonds.

If VAMC has failed to recover the "full value of the NPL debt", VAMC will repurchase the Special Bond at a price equal to the book value of the remaining principal balance of the NPL and credit any amounts recovered (after deducting fees and expenses of VAMC) through collateral sales, debt repayment, or otherwise to the credit institution. If VAMC has recovered the full balance of the NPL debt, the credit institution will return the Special Bond to VAMC in exchange for the full value of the debt. We would note that it is not clear from the drafting of Decree 53 whether the "full value of the debt" would include just principal, principal and accrued interest, or principal, accrued interest, fees and penalties. Since the Special Bonds are issued in face amounts equal to the principal amounts of the debt and VAMC has broad authority to forgive accrued interest, it likely only refers to principal.

Conclusion

The announcement of VAMC's formation is rightly heralded as a positive step in the Vietnamese banking sector's battle against NPLs and more broadly in the context of restructuring the banking sector. It remains to be seen as to how Decree 53 will be implemented in practice and further guidance will be needed. Important provisions, such as classification and definitions of NPLs for purposes of VAMC, and the mechanism for purchasing NPLs with cash, have not yet been addressed.

Vietnam will also need to make a critical decision as to what role it wants foreign investors to play in the development of VAMC, whether in terms of eligibility to purchase collateral in the form of real property assets, or partnering with VAMC as a funding source to purchase NPLs in "true sale" transactions.

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