

## Vietnamese NPLs: Towards a Secondary Debt Trading Regime?

The Vietnamese banking system has struggled to recover from the non-performing loan (NPL) hangover caused by high credit growth and loose lending practices in recent years. The first step in tackling NPLs was the formation of the Vietnam Asset Management Company (VAMC) in 2013 (as reported in 2013 in [“Vietnam Launches Asset Management Company to Tackle Non-Performing Loans”](#)) and the subsequent strengthening of its capabilities (as reported in 2015 in [“The New and Improved Vietnam Asset Management Company”](#)). Whilst this framework provided a mechanism for Vietnamese credit institutions to sell their NPLs to VAMC in exchange for special bonds that matured in five years, thereby enabling the banks to provision for the NPLs over a five-year period, VAMC was merely a warehousing structure to house the NPLs before returning them to the bank’s balance sheets. Though Moody’s found that NPLs fell to 6.8% of total lending by the end of 2016, the improvements are partly driven by rapid loan growth that does not ultimately resolve NPLs or reduce banks’ exposure to risk. The Resolutions on Trial Period of Processing Bad Debts of Credit Institutions of the National Assembly (“NPL Resolutions”) therefore comes as a breath of fresh air on revamping Vietnam’s management of NPLs.

The NPL Resolutions set forth a framework for a secondary market for NPL trading, which was high on the wish list for foreign and domestic investors alike. A groundbreaking feature of the NPL Resolutions is that investors other than Vietnamese credit institutions are expressly authorised to be transferees of security interests granted over immovable property, such as land use rights and fixtures.

Together with the Draft Amending Law on Credit Institutions (“CI Draft Law”) and the 2014 Law on Bankruptcy, Vietnam now is equipped with a more

effective arsenal for managing NPLs and moving towards a NPL trading market. However, lingering questions such as valuation methodology to price NPLs and the role of foreign investors in distressed trades remain unanswered.

### Applicability of the Debt Trading Regime

The NPL Resolutions are designed to stimulate a true secondary market for trading NPLs in Vietnam. The overarching goal is to align interests of credit institutions in selling their NPLs and those of debt traders looking to invest in NPLs. The NPL Resolutions will be effective for a five-year pilot program, and apply only to debts classified as NPLs before 15 August 2017, and to loans extended before 15 August 2017. Additionally, the NPL Resolutions stress that the state budget will not be used to process debts, nor does it allow the VAMC to purchase the NPLs of a joint venture or wholly foreign-owned credit institution.

### Addressing Pricing Uncertainties and Due Diligence Concerns

As NPLs are high-risk investments that are difficult to accurately value based on due diligence, many provisions in the NPL Resolutions aim to alleviate pricing and due diligence costs unique to NPL trading. The new legal framework provides several incentives to encourage NPL trades:

- The NPL may be sold at a price lower or higher than par. Given the risk of default, flexibility in pricing allows borrowers in financial difficulty to appeal to investors with NPL trades taking place at a discount to par value.
- Detailed guidelines are put forward on how to determine when a debt has become distressed and different categories of NPLs.
- Detailed accounting rules should provide better information for investors regarding the risk

profile and profitability of NPL instruments.

- Secured parties and transferees are not liable for the tax obligations of the securing party in registration processes and change of use or ownership rights during the transfer of security assets.
- Specific disclosure requirements are required in instances that secured assets are attached at the time of sale of a NPL.
- The requirement that NPL trading be done in a “public and transparent manner” may allow buyers to be more informed about sellers and their debt, and thereby more willing to conduct trades.

However, a major gap in the NPL Resolutions is that they do not provide details on valuation methodology or how to arrive at the “market” price. A major stumbling block for secondary debt trading in the past has been that officers of credit institutions are hesitant to rely on valuations to sell at a haircut, in particular as the new purchaser may profit from another secondary sale or realisation on the collateral. This is particularly acute in the context of state-owned banks.

## Enforcement of Collateral Recovery

The NPL Resolutions provide thorough guidance on procedures for recovery and seizure of security assets. Given the risks associated with trading NPLs in an emerging market such as Vietnam, clear guidelines on enforcement of collateral is important in facilitating NPL trading.

Credit institutions, foreign bank branches, or the VAMC may directly seize an NPL’s secured assets held by a borrower or third party, and foreclosure may be aided by police and other local authorities. Furthermore, the proceeds from security assets for NPL prioritise repayment of secured debt over tax and other unsecured obligations. Subject to a few narrow exceptions, the assets of a judgment debtor securing its obligation to repay a credit institution, foreign bank branch, or the VAMC cannot be seized to discharge other civil obligations.

When the security asset is immovable property (i.e., land use right or asset attached to land) the purchaser of the debt of a credit institution or foreign bank branch has the right to receive and register a mortgage, and is entitled as a successor to the rights and obligations of the mortgagee.

## Role of VAMC

VAMC is given substantial flexibility in the purchase and sale of NPLs. It is allowed to sell NPLs to legal entities and individuals, regardless of their ability to trade debt. This implies that a purchaser of NPLs does not need to be licensed as a debt trader, thereby opening the door to foreign invested entities to purchase NPLs. This revision permits sales to individuals or organisations without enterprises established with charter capital greater than VND 100 billion, or approximately USD 4.4 million, as required under the pre-existing legal framework. When the purchased debt is secured by immovable property, VAMC will register a mortgage.

## Limitations of the Resolution

The NPL Resolutions nevertheless contain gaps:

- They do not define “market” price or suggest how credit institutions can be comfortable that the valuations can form the basis of a trade without adverse consequences to the individual officers of the credit institutions making the decision to sell the NPL.
- It is unclear whether the Resolution can apply to direct transactions between credit institutions and investors without using VAMC as an intermediary.
- It is not clear whether foreign investors can purchase NPLs.
- Given restrictions on taking security over immovable property in Vietnam, there will need to be further detailed guidance on how non-bank investors in NPLs could continue to maintain mortgages over immovable property and enforce those mortgages.
- Other areas of Vietnamese law, such as strict regulations on the financial services sector or those on disclosure of customer information, may deter investment in distressed securities.

## Protections Against Predatory Investors

In other markets, many distressed borrowers are wary of the possibility that NPL investors seek to influence restructuring processes and pressure companies into a debt for equity swap or insolvency proceedings. However, the viability of these techniques may be limited in the Vietnamese context. Foreign investment ratios are capped in key sectors in Vietnam, including financial services. For instance, capital contribution in the form of buying shares in Vietnamese entities engaged in container handling services is capped at 50%. Furthermore, investment strategies that alter a credit institution's capital structure often require demanding regulatory compliance, including amendments to the corporate charter and enterprise registration certificate or investment certificate. Additionally, as discussed in 2015 in ["Vietnam Loosens Foreign Ownership Limit in Public Companies and Provides Guidance on Debt for Equity Swaps"](#), Decree 60/2015 set additional regulatory hurdles for public companies to engage in debt for equity swaps.

## Credit Institutions Draft Law

The CI Draft Law proposes adding a provision stating that the State Bank of Vietnam (SBV) will revoke the establishment and operational license of a credit institution after a judge appoints an administrator or enterprise to manage and liquidate its assets.

This law also discusses how the SBV will determine whether a credit institution is to be put under special control (akin to receivership under the SBV) and how it will decide termination of special control. For a credit institution under special control, the government ultimately approves the bank's restructuring or compulsory transfer plan and the SBV holds substantial influence in the credit institution's management and operations.

## Conclusion

Recent changes in the Vietnamese legal regime signal a move towards improved stability in the financial services sector. A secondary market for NPL trading is a particularly well-received development since, in addition to preserving market reputations and improving risk profiles of banks, a well-functioning secondary market would boost foreign investment and free up more capital for the greater economy. That said, the NPL Resolutions remain vague on key issues that investors and banks alike have struggled with for years – in particular, the role of foreign investors in the process and issues related to valuation methodology. The NPL Resolutions will need to be further refined through secondary legislation, in particular, on key matters such as entities other than credit institutions holding security over land with respect to financings.

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