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Decree on Foreign Banks

March 2006

>>> *This update discusses the implications of Decree 22-2006-ND-CP of the Government dated 28 February 2006 on Organization and Operation of Foreign Bank Branches, Joint Venture Banks, 100% Foreign Invested Banks and Representative Offices of Foreign Credit Institutions in Vietnam*

1. Introduction

In June 2004 the National Assembly passed amendments to the 1998 Law on Credit Institutions (LCI)¹ to become effective as of 1 October 2004. One of the key areas of amendment was to ensure increased compliance with international agreements, such as the US-Vietnam Bilateral Trade Agreement (BTA), by in particular allowing 100% foreign invested banks (100% FIBs) to operate in Vietnam in addition to the other permitted forms of investment of foreign bank branches (FBBs) and joint venture banks (JVBs). Of note, under the BTA, the obligation to allow 100% FIBs as a form of investment by US investors is not required to take effect until 2010.

As positive (and premature) as this reform under the LCI appears on paper, it cannot be truly effective until the Government issues the necessary implementing regulations, detailing the criteria, procedures and scope of operation for the establishment and operation of 100% FIBs. At first glance, it appears that the long wait since October 2004 is finally over. The recently issued Decree 22-2006-ND-CP of the Government dated 28 February 2006 on Organization and Operation of Foreign Bank Branches, Joint Venture Banks, Banks with One Hundred Percent Foreign Owned Capital and Representative Offices of Foreign Credit Institutions in Vietnam (Decree 22) is effective from 24 March 2006.²

2. Forms of investment under Decree 22

FBB	A FBB is a dependent subsidiary of a foreign bank, for which the foreign bank has provided a written guarantee that it will be responsible for all obligations and undertakings of the FBB in Vietnam. The FBB has its own separate legal personality in Vietnam. The foreign parent bank must be established in a foreign jurisdiction and “[its] main and usual activities are banking operations” (undefined).
100% FIB	An 100% FIB is established as a separate Vietnamese legal entity, with capital being contributed only from foreign entities. Amongst the foreign investors, there must be a “parent bank” and it must hold more than 50% charter capital. The foreign parent bank must be established in a foreign jurisdiction and “[its] main and usual activities are banking operations” (undefined).
JVB	A JVB is established as a separate Vietnamese legal entity, with capital being contributed from one or more foreign banks and Vietnamese banks. Capital is not divided into shares. In JVBs, the capital contribution rate by the foreign bank(s) is capped at 50% of the capital of the bank. In “exceptional cases” (undefined), a foreign bank may have a higher capital contribution but only if approved by the Prime Minister.

¹ Law on Credit Institutions dated 12 December 1998 (as amended 15 June 2004)

² Decree 22 replaces the previous implementing Decree 13-1999-ND-CP of the Government dated 17 March 1999.

It was anticipated that the following restrictions on a JVB would be lifted by Decree 22, but they have not:

- > 50% cap on a foreign parent bank's capital contribution to a JVB.
- > Only domestic banks, not other domestic non-banking organizations, are permitted to partner with foreign banks in JVBs.

3. Capital requirement

Capital requirements are not specified in the LCI. The capital requirement for each form of foreign owned bank is not specified in Decree 22 either. We understand that the level of capital requirement was deliberately omitted from Decree 22 and will be the subject of a specific legal instrument.

Under previous law the capital requirement for a JVB was US\$10million and for a FBB was US\$15million. The Vietnamese online agency VNExpress posted an article on 16 March reporting an interview the previous day with Mr. Kieu Huu Dung, Director of the Banking Department of the State Bank of Vietnam (**SBV**), in which Mr. Dung is reported to have said that the minimum capital for a bank (which we presume to be a reference to 100%FIBs) will be VND1,000 billion (approximately US\$62.5 million). Not only Mr. Dung's comments in the above news report but also our informal discussions with SBV officials over the past 12 months indicate that the SBV has a reluctant attitude toward this new type of entity and that this proposed capital requirement is a backhanded way for the Government to discourage foreign investment in the form of 100% FIBs and to encourage foreign investment in the form of offshore banks purchasing (minority) shareholding in existing domestic banks. Such a high capital requirement coupled with restrictions on the operational network of the 100%FIBs (discussed below) may well achieve that result.

4. Operation and transaction network

Under the previous regulatory framework, the main operational difference between JVBs and FBBs was that JVBs could open transaction offices (subject to certain conditions), but FBBs could not. The inability of FBBs to provide transaction points outside their branch office was one of the biggest restrictions on operating a foreign owned banking institution in Vietnam.

Now under Decree 22, the following framework exists:

- > FBB: the opening of transaction points (điểm giao dịch) outside the head office of the FBB is permitted, but only in accordance with SBV regulations (yet to be issued) and subject to the LCI.
- > JVBs: the opening of transaction offices (sở giao dịch) (not to be confused with transaction points), branches, representative offices, subsidiary companies and professional units is

permitted, but only in accordance with SBV regulations (yet to be issued) and subject to the LCI.

- > 100% FIB: the opening of transaction offices (sở giao dịch) (not to be confused with transaction points), branches, representative offices, subsidiary companies and professional units is permitted, but only in accordance with SBV regulations (yet to be issued) and subject to the LCI.

A transaction point (điểm giao dịch) is defined as “a bureau set up outside the office of a [FBB] in order to conduct a limited number of transactions with clients in accordance with [SBV] regulations”. “Limited number of transactions” is vague, and we presume intentionally so. An explanatory memorandum to an early draft of Decree 22 provided the following explanation, and is an indication that the activities of FBB transaction points will be restricted:

“This provision is in accordance with the BTA commitments and the joining WTO negotiation, which has effect of restricting the operational network of foreign banks, creating more advantages for Vietnamese banks in widening operation. While foreign bank branches almost have no limitation on their professional activities, this provision is important restriction on foreign bank branches, which Vietnam should maintain in certain period in order to continually protect VN banks in the transitional period.”

Foreign investors hope that the new Decree 22 means that at least FBBs will be able to establish an ATM network, an improvement on the pre-Decree 22 situation. However, by not specifically referring to ATMs, it is clear that a level of discretion is being left with the SBV. Investors will have to wait for a SBV circular to be issued to find out the extent of this new reform. Permitting FBBs to open an ATM network is a BTA requirement.

A FBB may open additional branches (article 34 of Decree 22) but to do so all conditions, including the minimum capital requirement, apply to each branch opened.

A transaction office (sở giao dịch) is not defined in either Decree 22 or in the LCI. Under Decision 1090³, in the context of JVBs, a “transaction office” is defined as a section belonging to the JVB, with its own seal, its main operation being raising capital and lending within a locality and conducting a number of other professional banking activities on authority. This is obviously more than an ATM.

³ Decision 1090-2003-QĐ-NHNN of the Governor of the State Bank dated 17 September 2003

The LCI stipulates that the following conditions must be satisfied for a (foreign or domestic) credit institution to open a transaction office:

- > The institution must have written approval of the SBV.
- > The institution has operated for a duration of no less than the minimum duration of operation stipulated by the SBV;
- > Business operations conducted by the institution are profitable; the institution has a sound financial status;
- > Administrative and management mechanisms and internal inspection systems of the institution are effectively operated;
- > The institution has established an information system capable of meeting management requirements;
- > The institution has not committed any breach of the regulations on safety in banking and other relevant provisions of the law.

Similarly to foreign representative offices in other fields, a representative office of a foreign credit institution is not permitted to conduct business activities in Vietnam.

The other sub-forms of operation for FBBs, 100% FIBs and JVBs - ie branch, subsidiary company and professional unit - are undefined, and it is not clear what the differences between each are.

5. Required assets of foreign investor

Under Decree 22, in order to receive a licence to open a FBB, the foreign parent bank must have total assets of at least US\$20 billion in the year prior to applying for the licence.

In order to receive a licence to open an 100% FIB or a JVB, the foreign parent bank must have total assets of at least US\$10 billion in the year prior to applying for the licence.

It is not clear whether the “assets” of the foreign parent bank include intangible as well as tangible assets. Again, this should be clarified in implementing circulars issued by the SBV.

The foreign parent bank must also satisfy a number of other requirements including that it has not committed a “serious breach” (undefined) of the regulations on banking operation or other laws in its home country in the 3 years prior to applying for a licence; and that it has international operational experience and has been classified by international credit rating institutions “at a level of having the capability to implement financial undertakings and to continue normal operation even when the

economic status and conditions change towards a non-profitable direction". It is not clear what this latter requirement means.

The foreign parent bank must satisfy the requirements of international customs regarding minimum capital safety ratio – we presume this is the Basel I Accord rate of 8% - and other prudential ratios.

6. Duration

FBBs, 100% FIBs and JVBs can now be licensed for up to 99 years. Under previous law, the maximum duration for a FBB was 20 years and a JVB was 30 years.

The duration of operation of a representative office must not exceed the duration of operation of the foreign parent bank. Potentially, the representative office could have an unlimited duration. Under previous law, the maximum duration for a representative office was 5 years (but renewable). This reform under Decree 22 is consistent with the term of foreign representative offices in other fields.

7. Language of transactions

In any banking transaction between FBBs, 100% FIBs or JVBs and a Vietnamese individual or organization, the documents must be in Vietnamese.

8. Conclusion

A lot of excitement has been generated by the long awaited issuance of Decree 22. However we consider this excitement may be premature. Much detail is still to be decided - fundamental matters such as the minimum capital requirement for the different forms of foreign owned banks and the extent of the operations network permitted are unknown. Decree 22 may just be paying lip service to Vietnam's BTA obligations and merely creating a favourable impression for Vietnam's WTO negotiations - we will not know until we see whether there is devil in the detail of the further implementing regulations yet to be issued.