



Banking System Restructuring

State Bank of Vietnam & Standard Chartered Bank

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Issues

- Banking System Restructuring
- Regulatory regime, enforcement and bank compliance

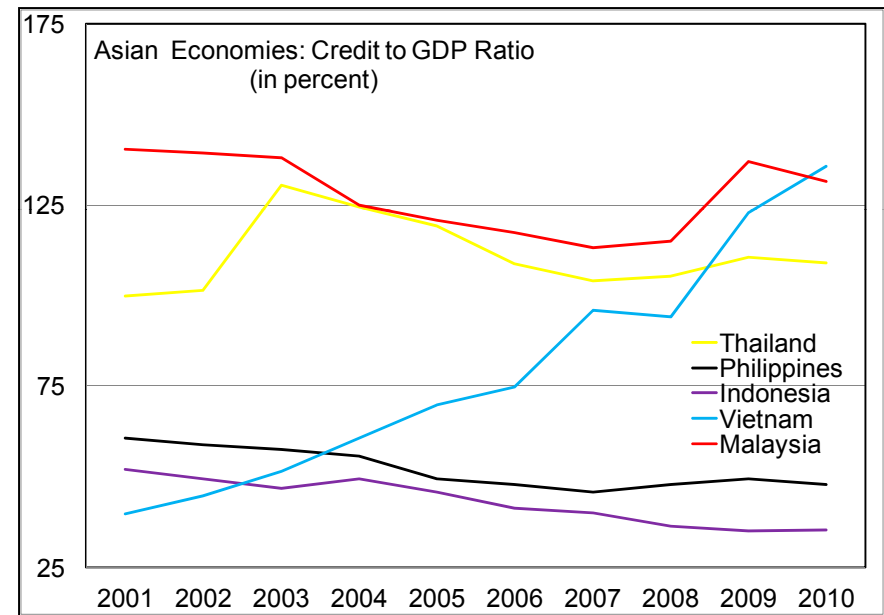
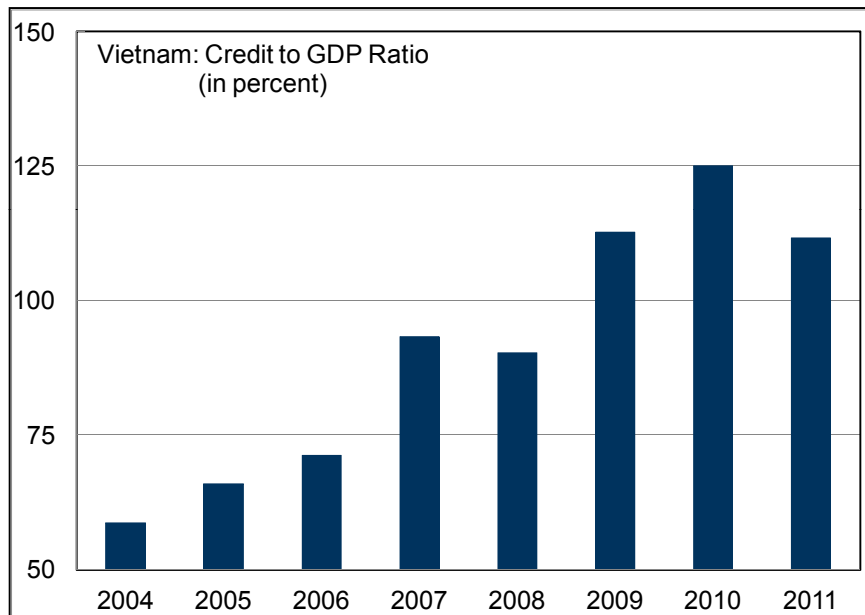
Banking System Restructuring

- Necessity
- Initial conditions
- Where to?
- What to expect?
- How?

Necessity

- Why? Why Now?
 - Crisis, vulnerability, and weak confidence
 - Macro-financial linkages
 - Macroeconomic stability \leftrightarrow Financial sector stability
 - Monetary policy implementation and weak banks
 - Inflation, expectations, confidence in the dong
 - Dong, dollar, gold, and other assets
 - Financial sector soundness and long-run growth

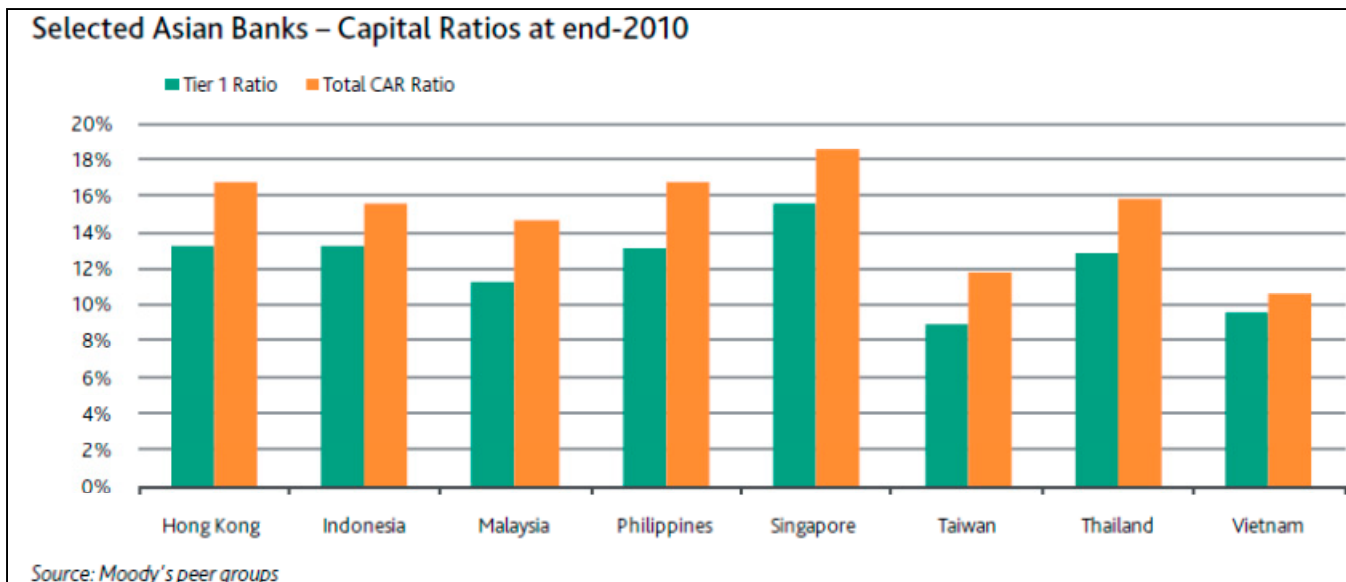
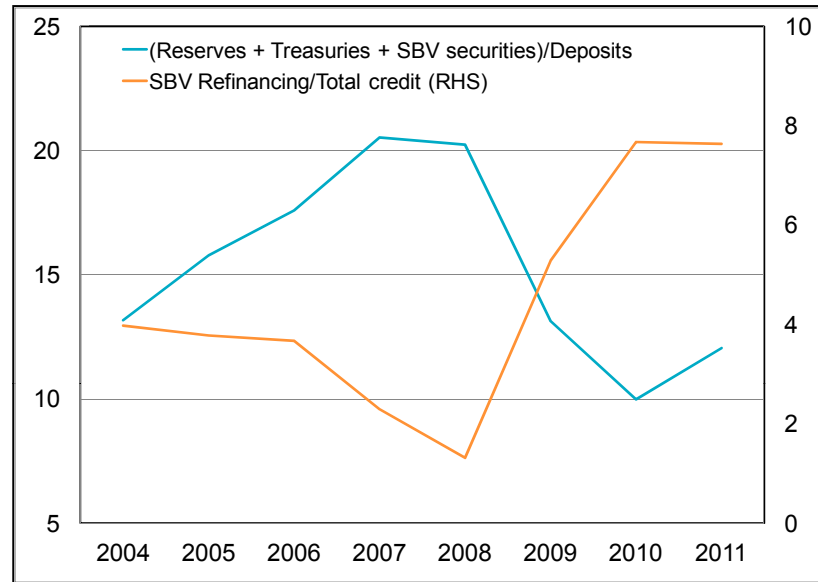
Initial Conditions: The Credit Binge ...



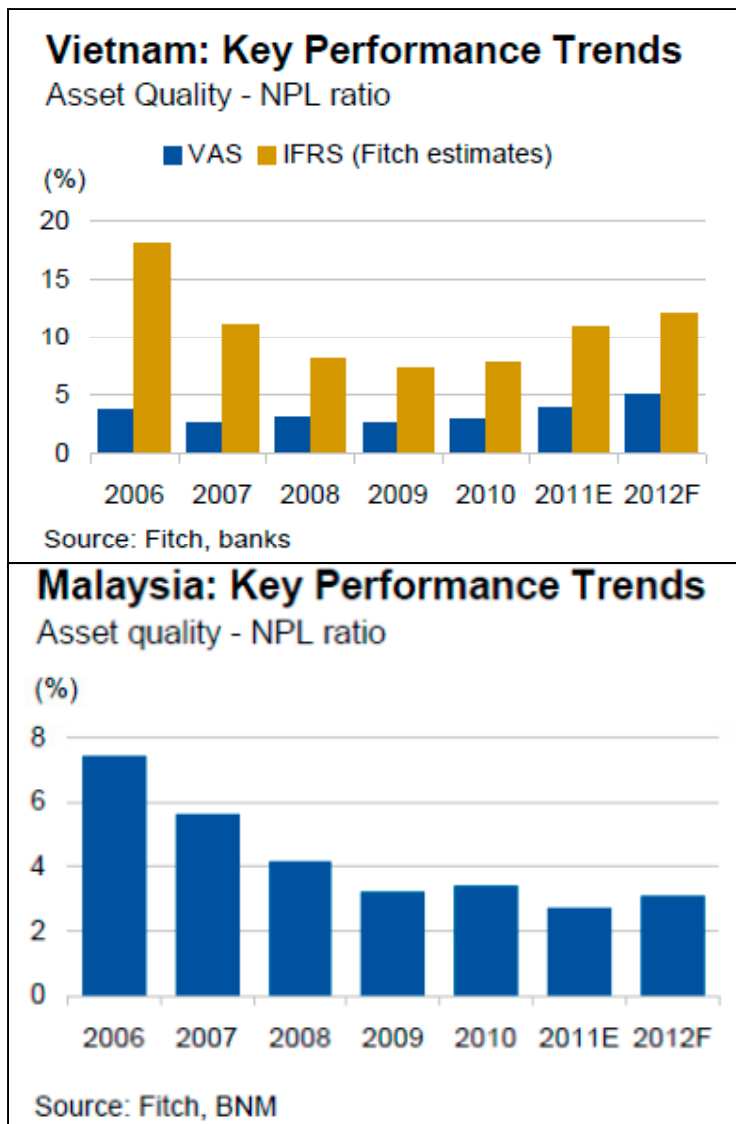
... and the hangover

- Liquidity problems in weak banks
- Solvency
 - Low capital adequacy/banks have limited buffers
 - Banks' NPLs
 - Low by VAS, but much higher by IAS/IFRS
 - Exposure to Vinashin/financially weak SOEs unknown
- Unsustainable business models
 - Growth expectations
 - RE prices
 - Noncore/other businesses

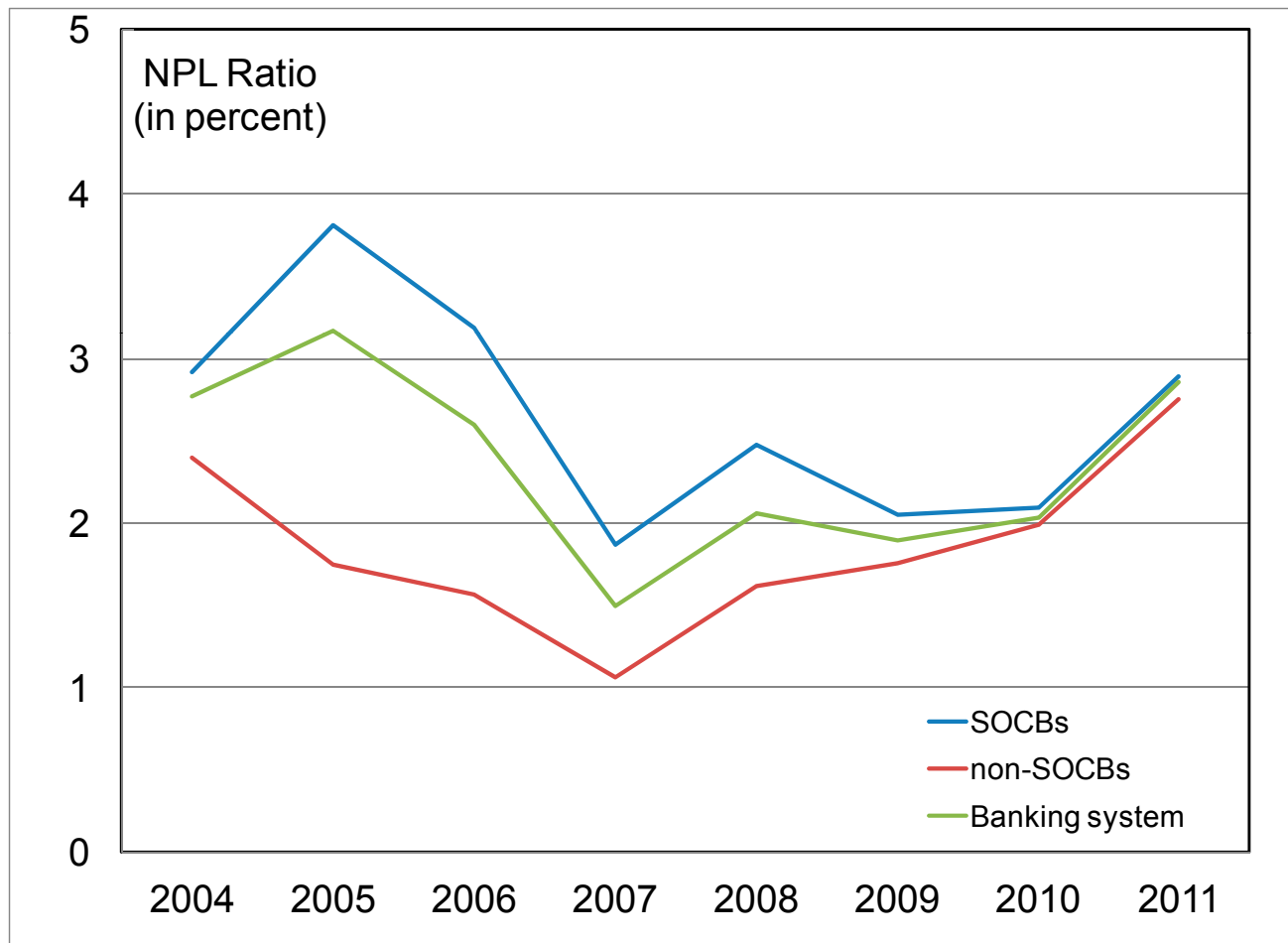
Initial conditions: Liquidity Stress and Capital Adequacy



Initial conditions: NPLs—size/credibility



Initial conditions: NPLs—composition



Where to—Objectives and Goals

Immediate/Short-term

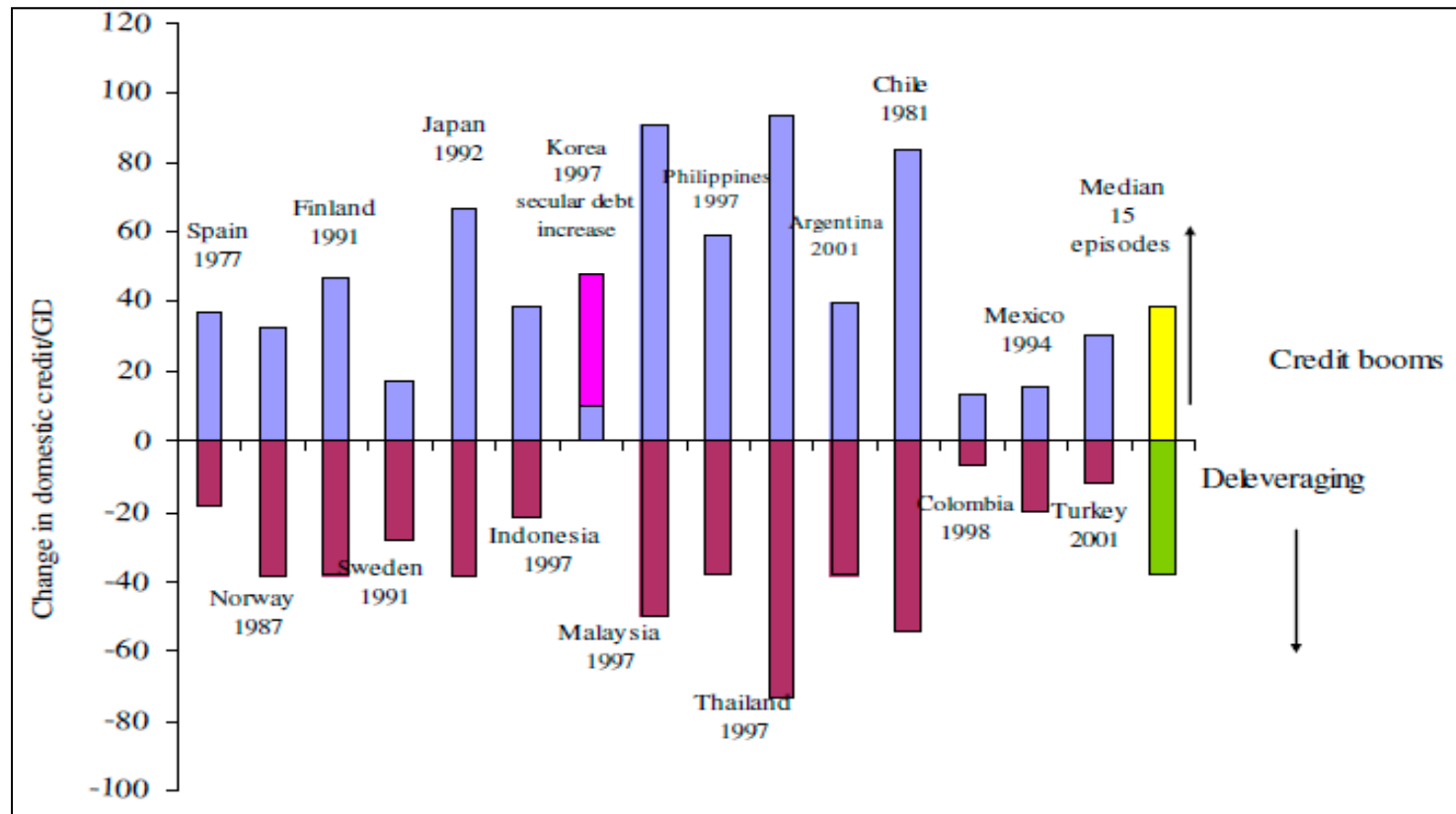
- Maintain stability of banking system → Ensure solvency, liquidity and uninterrupted financial intermediation
- Address problems in a timely manner → Prevent contagion or systemic concerns
- Restore confidence in banking system → Prevent deposit runs

Longer-term/Structural

- New governance framework
 - must preserve/create incentives for: (i) new private capital; and (ii) bank discipline in lending
 - allocate first losses to shareholders
- Improve operational efficiency/consolidation
 - only viable/sustainable banks should remain
- Build competition and resilience
- Strengthen overall infrastructure of financial system
- Improve access to financial services

Sources: S. Goyal 2012 (WB) and L. Taylor 2012 (SCB).

What to expect—deleveraging/duration



Amplitude of Boom-Bust Credit Cycles (10 yrs before and after)

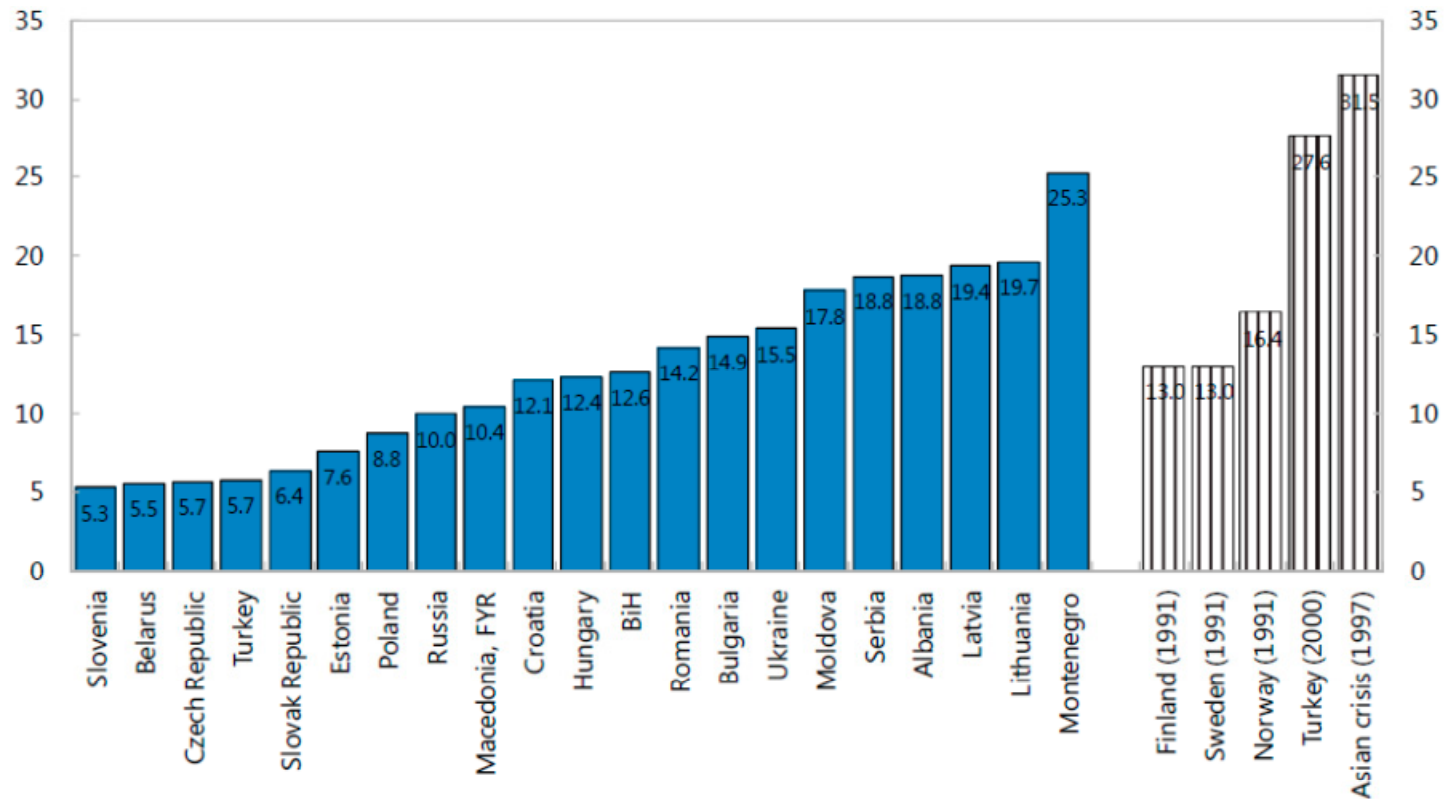
Source: Rogoff and Reinhart (2010).

What to expect—Weak credit growth

Channels

- Supply
 - Higher funding costs
 - Higher interest margins
 - Lower capitalization
- Demand
 - Overextended borrowers have lower credit demand

What to expect—Peak NPLs

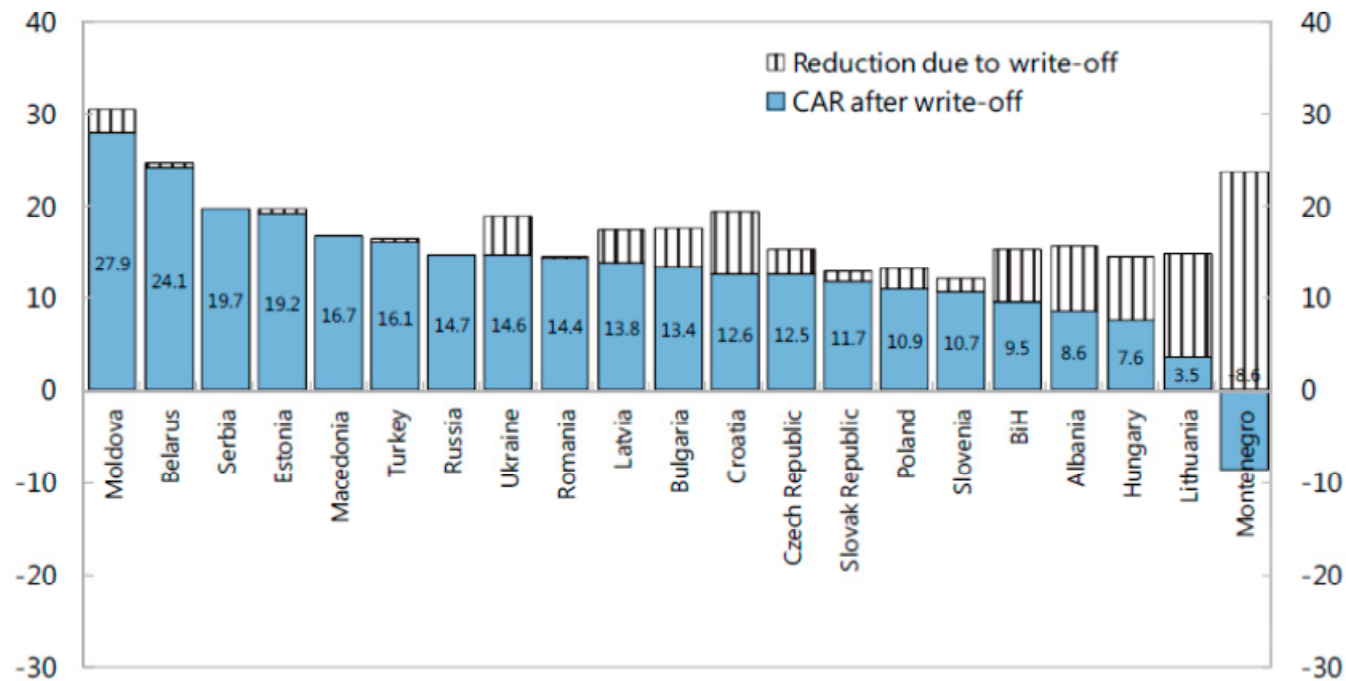


* For CESEE peak ratio during 2009-2011. Data are not fully comparable across countries due to differences in national classification practices.

Source: Working Group on NPLs in Central, Eastern and Southeastern Europe, March 2012.

What to expect—Lower capital adequacy

CESEE: CAR Under Complete Write-off of Existing NPLs (in percent of RWA)

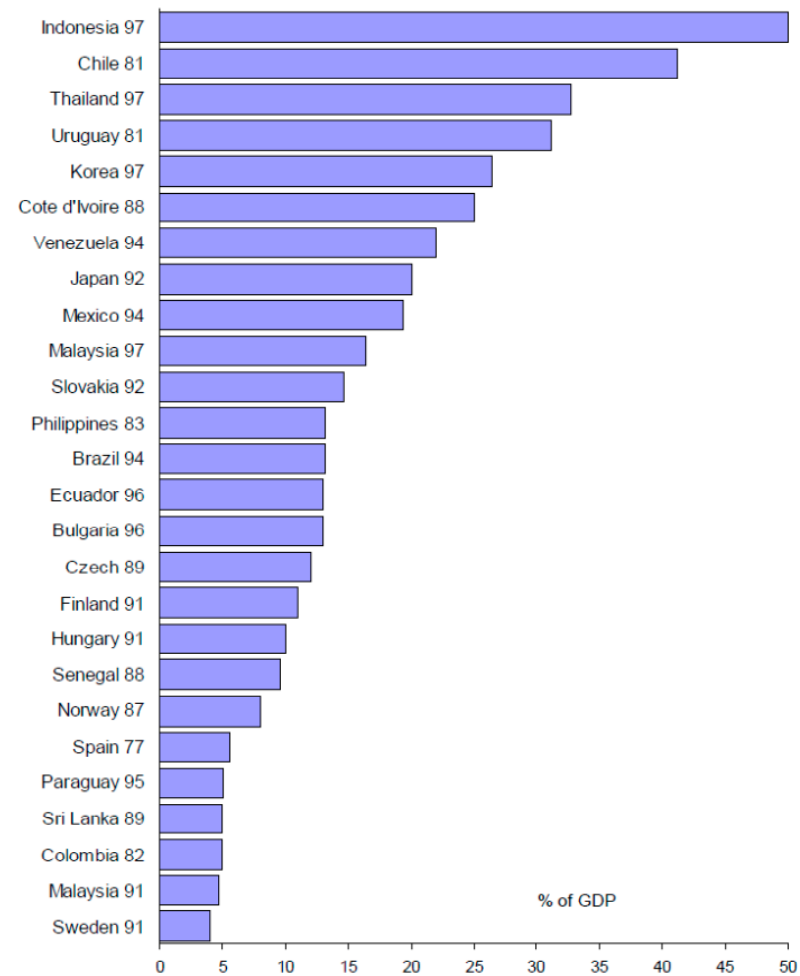


Sources: Country authorities; IMF country desks; and IMF Statistics Department for CAR, NPL ratio, provisioning ratio; Bankscope for RWA/loans; and IMF staff calculations.

* Based on data for end-2011 or latest available. Results not fully comparable across countries due to differences in national FSI data. Provisioning ratio capped at 100 percent for the purposes of this exercise.

Source: Working Group on NPLs in Central, Eastern and Southeastern Europe, March 2012.

What to expect—Fiscal Cost of Bank Restructuring



Source: Honahan and Klingebiel (2000).

How—Thou shall be ...

- **Clear**
 - diagnosis: sound technical & economic considerations
 - objectives and goals
 - choices and trade-offs
 - comprehensive, well-sequenced plan; intermediate targets and time lines
 - roles and responsibilities
 - role of the State
- **Comprehensive**
 - ensure monetary & financial stability while restructuring
 - enhance regulatory framework and ensure effective implementation
 - reform the corporate sector concurrently
 - nonbank financial sector (finance/leasing/securities companies)
 - policy banks (VDB and VBSP)
 - diversify risk in financial system by developing the capital market
- **Firm**
 - withstand political and interest group pressures
 - limit moral hazard
- **Transparent and communicative**
 - effective public communication with consistent messages

How—Problems and Responses

Sign/Indication	Possible Response/Approach
Systemic rise in NPLs	Higher capital and provisioning requirements; Address bad debt (AMCs, Bad bank-Good bank model, Bridge Bank); corporate restructuring
System capital low (fear of insolvency)	Force owners to inject more capital; Facilitate investor access (e.g, allow higher foreign investors participation), Conditional access to recapitalization funds
Banks having difficulty raising funds (deposits)	Temporary provision of liquidity windows (lender of last resort function of central bank); Enhanced depositor protection to restore confidence

Source: S. Goyal 2012 (WB).

How—Choices and Trade-offs

	Speed	Fiscal Cost	Incentive For Future Discipline	System Confidence
Full bailout by state	Fast	High	Low	Low
			Mistakes are largely unpunished	Undermines confidence in future of system
Selective Closure/ Recapitalization/ M&A	Medium	Low/Medium	Moderate/Good	Strong
		Depends on gains eventually realized, and “pain” for “bad bank” equity holders	If “bad bank” equity holders take first/full loss	Tangible progress towards fewer, stronger, better-managed banks
Close unviable banks	Fast	Potentially high	Good	Low
		if unrecognized losses are large	Equity holders pay for mistakes	Undermines confidence in future of system

Source: L. Taylor, 2012 (SCB).

How—Mechanics

- Conservatorship/Temporary Administration/“Bridge Bank”: appointment of manager for bank’s senior executive; goal to reform operations to improve financial health or prepare for sale/merger
- Purchase and Assumption (P&A)/ “Good bank-bad bank”: transfer of troubled bank’s operations to healthy bank; withdrawal/cancellation of license; termination of owners’ rights; assumption of deposits and good assets; take-over of problem assets by the resolution authority.
- Nationalization: government assumes temporary ownership
- Liquidation/Closure: license withdrawn, assets sold to pay liabilities/depositors/creditors; deposit insurance covers depositors up to limit; bank owners recover ownership interests only after all other bank creditors have been paid

How—Addressing NPLs: Asian AMCs

	KAMCO (Korea)	Danaharta (Malaysia)	IBRA (Indonesia)	TAMC (Thailand)
Objectives	Freeing banks from NPLs and supporting corporate restructuring while maximizing recoveries.	Freeing banks from NPLs and maximizing recoveries.	Assist banks in recapitalizing; aim at maximizing recoveries.	Supporting recovery of the corporate sector.
Structure – Policy Board	Professional Management Committee, with 5 out of 10 members from the private sector.	Professional and independent Board of Directors, with 6 out of 9 members from the private sector.	Professional Oversight Committee, with most of the 7 members from the private sector.	Non-professional Board of Directors, with 3 out of 11 members from the private sector.
Pays with	Interest-bearing KAMCO bonds guaranteed by the government.	Zero coupon Danaharta bonds guaranteed by the government.	Bank losses from selling NPLs at full discount were made up with issuance of interest bearing government bonds.	Interest-bearing TAMC bonds guaranteed by the Financial Institutions Development Fund (FIDF).
Funding	Contributions from FIs. Borrowing from Korea Development Bank. Issuance of government guaranteed bonds.	Government capital injection. Issuance of zero-coupon government guaranteed bonds.	Government capital injection. Operational cash-flow from asset recoveries.	FIDF capital injection. Issuance of FIDF-guaranteed bonds. Loan recoveries.
Asset disposition and management	Auction; public sale; equity partnership; and securitization.	Private auction; tenders; securitization; special administration (business restructuring).	Restructuring of larger loans; outsourcing of medium-sized loans; auctions of smaller loans; foreclosure.	Debt and business restructuring; foreclosure; outsourcing.
Special Powers	n.a.	Appointment of special administrator for business restructuring. Foreclosure on collateral.	Power to seize debtor assets.	TAMC-administered business restructuring largely bypassing court process. Foreclosure on collateral.

Source: Girogiani, L. (2001).

Banking Restructuring Plan

- Overhaul and improve governance to international standards
 - Better disclosure
 - Broadened shareholder base, SOEs to exit bank ownership, reduce influence of large shareholders
 - Upgrade regulatory inspection and supervision
 - Introduce Basel II risk management by 2015
 - Capital; A/D ratios; IAS
- Temporary liquidity to institutions in need, subject to restrictions on operations
- Assessment of NPLs in JSCBs
- SOCBs stay dominant, and internationalize
- Healthy JSBs can undertake voluntary and/or forced M&A
- SOBCs and healthy JSCBs can buy good assets from weak banks
- State intervention to resolve NPL portfolios
- DATC of the MOF to acquire NPLs

Banking Restructuring Plan: Some Issues

- Many good features, but ...
- Need real distinction between liquidity and solvency support
- Reluctance to close insolvent banks; willingness to expend state funds to support weak banks, focusing on mergers and acquisitions
- International best practice—private shareholders of weak banks take first loss in any resolution
- Loan classification—VAS or IRS?
- International experience with centralized, public asset management companies—mixed results, at best
- Directed lending—need to separate commercial/policy lending
- Needs more emphasis on good corporate governance

Regulatory Regime, Enforcement and Bank Compliance

- Regime and enforcement
- Bank compliance

Regime and Enforcement

Legal framework

- Law on the State Bank of Vietnam
 - Articulate fully and forcefully SBV's role as guardian of banking system soundness
- Law on Credit Institutions
 - Progressive enforcement measures
 - Article 50: Governance/"Fit and Proper"
 - Honesty, Integrity, Reputation
 - Competence and capability
 - Financial soundness
 - Insolvency regime under LCI
- Other agencies (DIV, MOF, NFSC)
 - Eliminate overlap among agencies responsible for banking regulation/oversight
 - Ensure coordination among agencies
- Conflict of interest
 - SBV is regulator/agent of owner for SOCBs

Regime and Enforcement

- Supervision defined
 - BCP for Effective Bank Supervision: the full range of activities that regulatory authorities are responsible for to promote a safe and sound banking system—licensing, off-site analysis, on-site bank inspections, enforcement , revocation of licenses
 - Vietnam: 2 separate parts
 - Supervision: SBV's authority to collect and analyze information from banks, and deal with technical/professional violations of regulations.
 - Inspection: supervisory activity on banking risk and compliance with laws and regulations on banking and monetary activities.
- Supervision implemented—FSAP to provide more information
 - Objectives, independence, powers, transparency and cooperation (1)
 - Licensing and structure (2-5)
 - Prudential regulations and requirements (6-18)
 - Methods of ongoing bank supervision (19-21)
 - Accounting and disclosure (22)
 - Corrective and remedial power of supervisors (23)
 - Consolidated and cross-border bank supervision (24-25)

Regime and Enforcement

- Objectives, independence, powers, transparency and cooperation
 - SBV is a government body
 - No legal protection for supervisors; series of penalties; human capital and resource constraints; qualified staff retention
 - Confidentiality of information obtained during bank supervision process
- Methods of ongoing bank supervision
 - Still primarily focused on determining compliance with laws/regulations
 - No/not enough focus on forward-looking analysis of risks (FSIs/EWS)
- Accounting and disclosure
 - Vietnamese Accounting Standards, not consistent with international standards
 - Calculation of NPLs, loan loss reserves, capital adequacy
 - Timeliness of disclosure
- Corrective and remedial power of supervisors
 - Action to restructure/close banks under special supervision
 - Violation of minimum capital requirements—handling
 - Ability to detect, handle, avoid, prevent violations
- Consolidated and cross-border bank supervision
 - Activities of affiliated companies/subsidiaries

Bank compliance

- Internal
 - Strengthen bank operations and governance
 - Cross-holding, transparency, accountability
 - Management and operational efficiency
 - Organization and personnel
 - Lending standards and use of capital
 - Risk management and supervision systems
- External
 - Market discipline
 - Stock market listing

Thank you