



# TO RESTRUCTURE THE SYSTEM OF COMMERCIAL BANKS

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The banking system is the main artery of the economy and there will be no strong economy if the banking system is badly managed, and vice versa. One of main causes of the recent financial crisis, as identified by economists, was the weak and badly-managed banking systems. One of the first measures to repair damage caused by the crisis is to restructure the banking system.

The crisis didn't break out in Vietnam but the Vietnamese economy was also greatly affected and along with signs of decline which could be seen in the past two years, shortcomings in the banking system after ten years of economic reform have also made their appearance. The VCP and Government have decided to beef up the banking system.

In Indonesia, the banking reform program has been carried out for more than a year. Before the crisis, there were 237 banks of all kinds

and up to now, 54 banks were closed for good, 12 were taken over by the State, 11 were merged into stronger ones and 9 were refinanced by the central bank (the refinanced capital represented some 80% of their working capital). The banking reform program was carried out first in private commercial banks, and when this sector was settled, the reform in state-run commercial banks started. After nationalizing a series of commercial banks in March 1999, the Indonesian government could control three quarters of the banking system.

In Thailand, after closing 57 commercial banks and finance companies in late 1997, the Thai government took various measures to reform the banking system. First Bangkok City Bank, the seventh biggest bank in Thailand, was merged into Krung Thai Bank, the third biggest bank. Bangkok Bank of Commerce, the 10<sup>th</sup> biggest, will be closed by next October. Some

other banks have been merged, acquired or had the better part of their shares sold. Radanasin Bank, Siam City Bank and Bangkok Metropolitan were either nationalized or taken over by the government who is making plan to sell them to private investors. Among potential buyers are important financial institutions such as HSBC, ABN-ABRO Bank, Citibank, Standard Chartered Bank, etc.

Another measure is to issue new shares. It's the measure taken by two Thai leading banks: the Bangkok Bank has issued US\$1.1 billion worth of shares and debenture certificates; and the Thai Farmers Bank, by issuing shares, also raised a fund three times higher than the minimum level required by the government.

The Thai government has taken the four following measures to beef up the banking system:

- Forming a state-run debt management company to buy debts from



banks and sell them at a discount price.

- Nationalizing badly-managed banks and refinancing them.

- Introducing a mechanism for writing off bad debts and encouraging potential investors to put money in banks.

- Dissolving or closing weak financial institutions, and having them merged or sold to other banks.

Those measures have been also taken by many Asian governments to restructure their banking systems. We can see now what measures have been taken by the Vietnamese government.

1. The Government has long considered forming a Mortgaged Assets Company but this plan has never been put into practice because of many difficulties:

- + The company needs a starting capital of some VND500 billion, not to mention expenses on office equipment, office building and personnel, while the Government is suffering a budget deficit.

- + There is no perfect legal infrastructure and mechanism for dealing with mortgaged assets (performance of Assets Auction Center, procedures for bringing a dispute before the economic lawcourt, methods of evaluating mortgaged assets, deciding on ownership of assets according to Decree 17/CP, etc.)

After being given the seal of approval by the PM, an interdepartmental circular (signed by the SBV, Ministry of Finance, Ministry of Justice, Supreme Court and Supreme Prosecution) was issued to provide methods of dealing with mortgaged assets. This circular, however, hasn't come into effect yet.

On April 19, 1999, the SBV Governor signed Decision 140/1999/QĐ-NHNN1 providing regulations on debt swap by banking institutions. But in reality, no debt has been traded so far because this operation is totally strange to banks and their officials.

In such a situation, the total bad debt of some VND6,000 to 7,000 billion hasn't been liquidated. The banking system, especially commercial ones, have tried to find solutions of their own to the problem. However, due to the general recession of the economy, the more they try to reduce bad debt, the more it increases. The Government, and ministries as well, have no effective measure to help banks to deal with this problem.

2. As for the measure to nationalize private commercial banks

and refinance them if necessary, the SBV Governor has issued Directive 02/1999/CT-NHNN5 allowing state-run commercial banks to buy share capital and take control over private commercial banks. But up to now, for some reasons or another, no state-run bank has realized this policy because most of them have buy shares from many commercial and joint venture banks. The Vietcombank for example, has had interests in eight commercial banks and six companies. In addition, to buy shares from other organizations, the state-run commercial banks should use their retained profit while their legal capital is limited and they haven't received this capital in full from the general treasury.

By the end of 1998, as approved by the Government and Ministry of Finance, the SBV changed VND2,400 billion worth of debt owed by state-run commercial banks to the central bank into capital refinanced by the government to these banks on the condition that these banks should consider part of debt owed by state-run companies to them as capital refinanced by the government to state-run companies.

Thus, this measure was adopted by the Vietnamese Government but it wasn't carried out.

3. Regarding the measure to issue more shares and introduce a debt swap mechanism, the SBV has demanded commercial banks to increase their legal capital. Besides some profit-making commercial banks that could provide shareholders with a dividend higher than the bank deposit rate succeeded in making new issues and increasing their legal capital as required, many others failed to do it because of various reasons (bad management, poor performance and organization, badly-trained personnel, legal restrictions, etc.). Up to April 1998, the total legal capital of commercial banks increased only by 3.8% in comparison with 1998 and their average legal capital stayed at some VND50 billion.

There is no mechanism allowing banks to write off bad debts. On Feb. 2, 1999, the SBV Governor made Decision 48/1999/QĐ-NHNN5 on classification of assets; and formation and use of contingent fund by banking institutions and the Decision came into effect in the first quarter of the year. Commercial banks could debit to bad debt accounts all debts which are 360 days overdue, and

50% of the value of debts from 180 to 360 days overdue. This mechanism has helped to improve the banks' financial situation.

4. As for the measure to close or merge loss-making commercial banks, the SBV decided to close these banks in good order because a bank closure could lead to a bank run and then, to social unrest.

The SBV, after considering the situation and getting approval by the shareholder meeting, has asked the Viễn Đông Commercial Bank to stop receiving deposits and supplying loans, and start collecting debts and repaying its depositors. Within two years, the Viễn Đông Bank completed its business, returned the license to the SBV and shut down in early 1999.

The same solution was also applied to the Mekong Commercial Bank. In May 1999, this bank, with its license withdrawn, was merged into the Quốc Tế Commercial Bank. The Đại Nam Bank, along with the Đồng Tháp Bank, were merged into the Phương Nam Bank in the same process.

Up to now, there are 50 commercial banks in Vietnam, including 30 city banks and 20 rural ones. According to an SBV estimate, 10 city banks are of grade C and D and most rural banks are of grade A. Banks of grade D will be closed, sold to or merged into other banks according to above-mentioned solutions.

Thus, the reform in the banking system was carried out slowly last year, but it caused no social unrest. Of four measures adopted by Asian countries, Vietnam took only the fourth one, the other three were agreed upon but they weren't realized effectively. That is why this reform should be accelerated. In this reform, help and cooperation from the Government and related ministries are much needed because the banking system couldn't carry out the reform and deal with all difficulties on its own.

Theoretically, the main content of this reform is the task of restructuring the banking system and it isn't limited to the act of dissolving this bank or merging some others together. It means restructuring both assets and liabilities of banks, making their financial situation sounder, increasing their capital, reorganizing the whole system and finally, enhancing the strength of the banking system. ■