

# PROBLEMS WITH CONTROL OVER DEFERRED PAYMENT L/C

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In 1995-96, opening deferred payment L/Cs became so widespread that most banks failed to control and settle them properly.

Everything looked very simple at first: by importing goods under deferred payment terms, local companies could employ capital of sellers; and banks could make some charge by allowing importers to open L/Cs. However, after importing goods, many companies were ready to sell them as fast as possible, even at reduced prices because they were badly in need of cash (for paying debts and taxes or investing in real estate, etc.) with the result that they defaulted on their debts when due. This way of doing business brought many big companies, such as Tamexco, Minh Phụng and Epco, to court.

Up to the end of 1996, the banking system guaranteed some US\$3 billion worth of deferred payment L/Cs, equaling 35% of export earnings in 1996. Most of these L/Cs were opened in HCMC and the value of overdue L/Cs opened between 1996 and 1998 was very great. The following table provides us a closer look at this situation.

Some problems have arisen from this situation:

(1) When banking authorities regained total control of banking services, the value of deferred payment L/Cs started to decrease. Up to Dec. 31, 1997, the value of deferred payment L/Cs guaranteed by banks reduced to US\$561.97 million, decreasing by 33% as compared with 1996; and to US\$498.76 million on Dec. 31, 1998, decreasing by 11% as compared with 1997. The value of deferred payment L/Cs as percentage of total outstanding loan reduced from 41% in 1996 to 26% in 1997 and 20% in 1998.

(2) When the L/Cs became due and importers failed to settle them, the banks had to pay the amount due to foreign sellers, and then, charge importers an interest fine equaling 150% of the normal lending rate for the overdue debt. That is why the value of forced loan granted by banks to default importers increased in recent years and amounted to US\$247.7 million on Dec. 31, 1997 (equaling 55% of the value of deferred payment L/Cs in 1997) and to US\$289.47 million on Dec. 31, 1998 (increasing by 16.8% as compared

with 1997).

(3) Realities show that the spread of deferred payment L/Cs is one of the causes that made overdue debts to banks increased incessantly in recent years. The value of overdue L/Cs rose from US\$103.6 million (equaling 25% of overdue debt to banks) in December 1997 to US\$137.12 million (or 27.9% of overdue debt) in Dec. 31, 1998.

(4) In 1997 when the Vietnamese banking system suffered a lot from the flood of deferred payment L/Cs, the Southeast Asian financial crisis broke out causing many disastrous consequences: price of the dollar on domestic market rose drastically, no companies wanted to sell foreign exchange to banks, and a bank run took place when depositors wanted to turn their money into foreign exchange. These consequences made it difficult for commercial banks to secure enough foreign exchange to settle deferred payment L/Cs.

(5) Although the banking authorities took many measures to limit the use of deferred payment L/Cs, importers with help from foreign sellers have been able to invent other kinds of L/C because banking

regulations aren't strict enough. For example, they introduced a refinancing L/C by which the foreign sellers agree to give grace when the payment is due, or used deferred payment TT thereby avoiding the regulation set by Decision 207 by the SBV Governor that requires a 80% deposit for certain lines of product imported under deferred payment terms. To reduce repayment risk, the SBV has required commercial banks to deposit 5% of the L/C value with the central bank when opening an L/C and this service should be well under control of the SBV.

At present, importers usually open at sight L/Cs because for this kind of L/C, the bank only requires them to deposit from 5% to 30% of the L/C value, and they can borrow from bank to settle the L/C and then repay within three or six months, therefore this is only a variation on the deferred payment L/C.

In addition, importers also faced exchange risk, because they have to pay in the VND when borrowing foreign exchange from the bank and have to pay 14% more when repaying the debt if the price of foreign exchange rises against the VND. This causes great difficulties to both borrowers and lenders because in both credit contracts and regulations on the supply of bank loan, there is no clause providing for changes in the exchange rate.

To solve the problems with overdue deferred payment L/Cs, we want to suggest the following solutions.

+ Re-examining all

Table 1: Deferred payment L/Cs in HCMC commercial banks in 1996-1998

	1996	1997	1998
Total outstanding loan supplied by commercial banks (VND bil.)	22,630	28,080	32,598
Overdue debt (VND bil.)	1,079	5,397	6,603
% of overdue debt	4.7%	19.04%	20.06%
Value of deferred payment L/Cs (US\$ mil.)	850	561.97	498.76
Value of deferred payment L/Cs (VND bil.)	9,350	7,277.5	6,705
Changes in value of deferred payment L/Cs		-33%	-11%
Value of overdue L/Cs as % of total outstanding loan	41%	26%	20%
Value of forced loan (US\$ mil.)		247.70	209.47
Value of unsettled L/Cs (US\$ mil.)		104.60	137.12





overdue deferred payment L/Cs and trying hard to collect debts, especially those owed by companies that have been prosecuted, as directed by Directive 08 issued by the SBV Governor on Oct.31, 1998.

+ Exerting total control over import: As for raw materials imported by companies with sound financial position, the bank can help them open at sight L/Cs. As for expensive equipment and machines which are beyond the bank's reach, deferred payment L/Cs could be opened on condition that some assets are given as security and the L/C is confirmed by a third party. In addition, the bank had better regularly inspect the way the borrower uses bank loans with a view to preventing wrong employment of capital that could make importers defaulters.

+ Regarding the legal aspect, the SBV had better issue directives preventing the use of variant forms of deferred payment L/C presented above. However, it's not necessary to be allergic to deferred payment L/Cs, because, thinking through, this kind of L/C is still of great benefit to the economy when we haven't got enough foreign exchange to import modern production lines and technology.



The SBV should work out regulations on the supply of loan in foreign exchange providing for measures to save importers from exchange risk when borrowing from, or paying to, banks. Moreover, other measures should be taken to stabilize the exchange rate.

+ As for the exchange control, the Government has paid full attention to this task in recent years by issuing many documents (such as Decision 37 by the PM on Feb.14, 1998 on procedures for opening accounts in foreign currency; Decree 63 by the PM on Aug.17, 1998 on

the exchange control and Decision 173 by the PM on Sep.12, 1998 on obligations in trading in foreign exchange). After three adjustments (\*), the official rate is now rather stable, steady flows of foreign currency to banks have helped satisfy the demand for foreign exchange. The following are our opinions about the exchange control:

-To help importers secure enough foreign exchange to pay foreign sellers, the banking authorities had better adopt a policy to give preferential treatment to certain importers who have sold foreign exchange to

bank in the past when the exchange rate was stable with a view to compensating them for losses caused by changes in exchange rate.

-To help importers balance their foreign exchange accounts when procedures for buying foreign exchange from banks are still complicated, the bank can decide on the amount of foreign exchange sold to each importer based on the value of payments in foreign exchange made through bank by the importer every year

In short, the task of controlling deferred payment L/Cs is not simply an international payment

operation, it also has a close relation to the supply of credit for import. This problem is also a serious worry to all commercial banks now. We hope that this article will cast some light on this task■

(\*) The official rate rose from VND11,175 to 11,800 to the dollar with a band of 10% on Feb.16, 1998; and to VND12,998 with a band of 7% on Aug.6, 1998. From Feb.28, 1999 on, the exchange rate has been based on the average market rate with a band of 0.1%.