



cutting through complexity

Vietnam Banking Survey 2013

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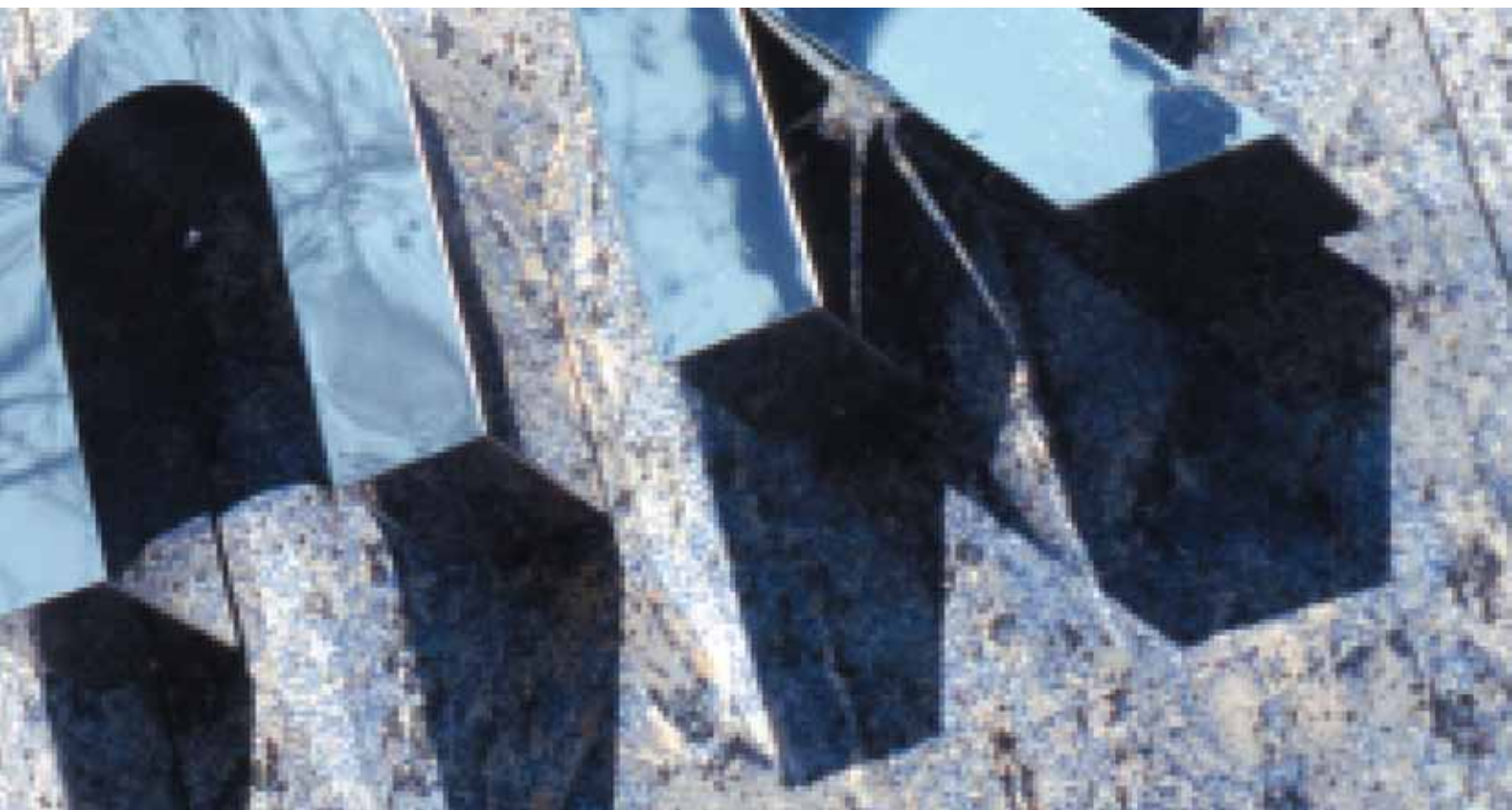
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EVOLVING BASEL REGULATION

An aerial photograph of a city, likely Hanoi, Vietnam, showing a dense urban landscape with many small buildings and roads. A large, semi-transparent blue banner is overlaid on the lower half of the image, containing the title 'INDUSTRY OUTLOOK & OVERVIEW' in white, bold, uppercase letters.

INDUSTRY OUTLOOK & OVERVIEW

Vietnam, like the rest of Asia, has entered a period of slower growth. Besides the manufacturing and agricultural sectors, other industry sectors are being adversely affected by the slower growth and the Banking sector is no exception. With lower credit growth, tighter margins and high levels of non-performing loans, it is evident that banks are operating in a challenging environment.



The picture is not all gloomy however and there are many positive signs on the horizon. The sector is seeing ongoing strategic interest from large regional and global banks looking to establish a foothold in Vietnam and the near term economic outlook is more positive now than it was a year ago.

To capture these challenges and promote discussion on possible solutions, KPMG in Vietnam are pleased to release the results from our inaugural Banking Survey. The survey questionnaire targeted commercial joint stock banks in Vietnam, with fully completed responses received from two thirds of the banks surveyed.

This document has three main parts:

- Part 1 KPMG sector analysis based on aggregated reported information obtained from the 2012 Annual Reports of 33 banks*
- Part 2 General Banking Survey
- Part 3 Basel Banking Survey

The picture that emerges from this survey is that there are 4 key challenges facing the Banking sector:

- » How NPL's will be resolved is clearly the biggest issue
- » How the sector will consolidate and who will be the key players
- » How can credit growth be accelerated without increasing risk
- » How to implement a workable Risk Management framework for the banking sector

* Annual Reports for all Vietnamese joint stock banks were not available or provided to us. The information reported has been extracted directly from the Annual Reports and it has not been independently verified or tested by KPMG Limited.

PART 1:

BANKING SECTOR ANALYSIS

1. BALANCE SHEET COMPOSITION OF 33 VIETNAMESE BANKS

Bank groupings and analysis

To assist with making meaningful comparisons, we have divided the 33 banks included in our analysis into four Groups based on their Charter Capital as at 31 December 2012:

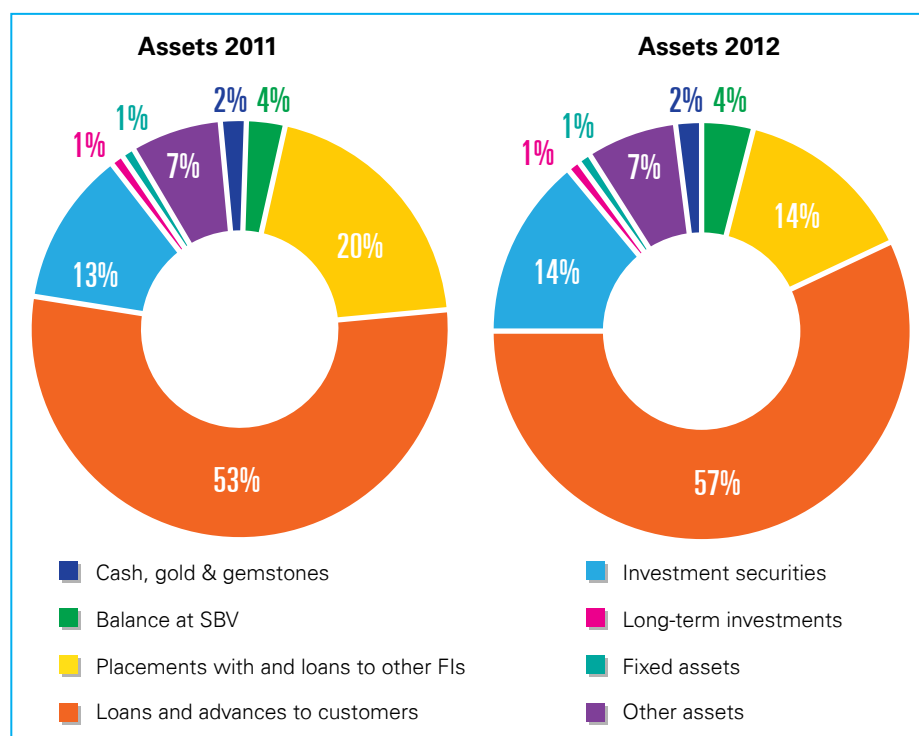
	Charter Capital	Number of Banks
Group 1	> VND 20 Trillion	4
Group 2	VND 5 Trillion - VND 20 Trillion	11
Group 3	VND 3.5 Trillion - VND 5 Trillion	7
Group 4	< VND 3.5 Trillion	11

Key findings:

- Loans are growing as a percentage of Total Banking Assets;
- Deposits from customers significantly increased in 2012;
- Interbank volume by the end of 2012 significantly decreased in comparison to 2011;
- Group 2 banks are the most active in the interbank market.



1.1 BANKING ASSETS



The three main components of banking sector assets as at 31 December 2012 were:

- Loans and advances to customers 57%;
- Placements with and loans to other FIs 14%; and
- Investment securities 14%.

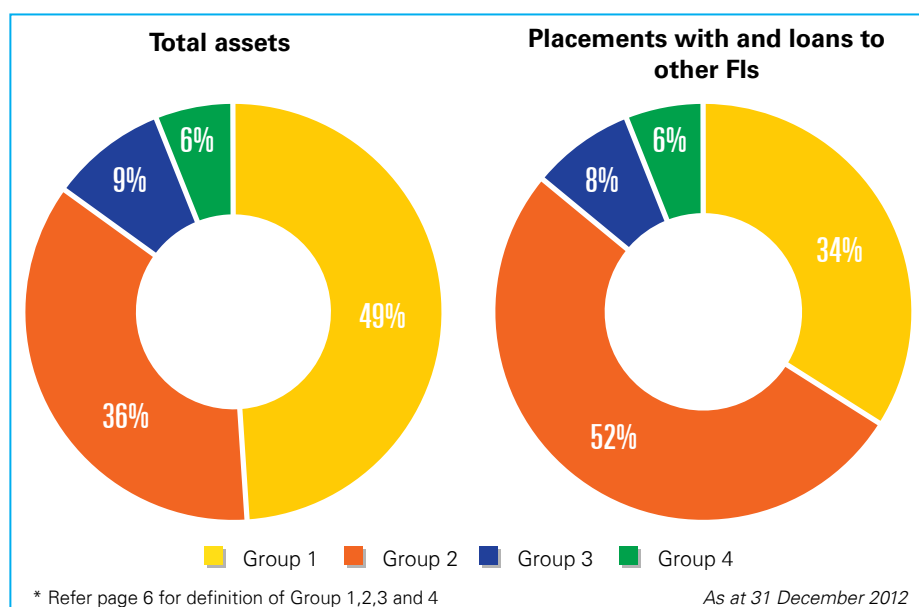
Compared with 2011, the main difference has been the year-on-year reduction in interbank lending from 20% to 14%. This is unsurprising given the large growth in system deposits which is discussed in the next section. The growth in deposits across the sector has reduced reliance on interbank borrowing as a source of funding for the loan book. On average however, deposits in Vietnam have been a more expensive source of funding, contrary to most developed markets where deposits are generally cheaper than interbank financing.

System credit growth in 2012 was reported as 8.91% and this is reflected in the increase in total lending as a proportion of total assets from 53% to 57%. It is interesting to draw some comparisons from the below table regarding asset composition in Vietnam and those of other regional countries.

Asset Composition across Asia-Pacific					
	Australia	China	Singapore	Thailand	Vietnam
Customer Loans	75%	50%	61%	64%	57%
Total Interbank	2%	3%	10%	8%	14%
Total Investments	6%	19%	11%	15%	14%
Other Assets	17%	28%	18%	13%	15%
	100%	100%	100%	100%	100%

Source: Country Central Bank data and published Annual Reports

Based on the country figures above, Vietnam's proportion of customer loans to total assets is one of the lowest in the ASPAC region. Only China has a lower loan/asset ratio and this is explained by the relatively high balances (18%) held by Chinese banks at the central bank, the People's Bank of China, affecting their lending capacity. On the other hand, the Vietnamese interbank market is the most active in the region, notwithstanding this has decreased significantly year on year.

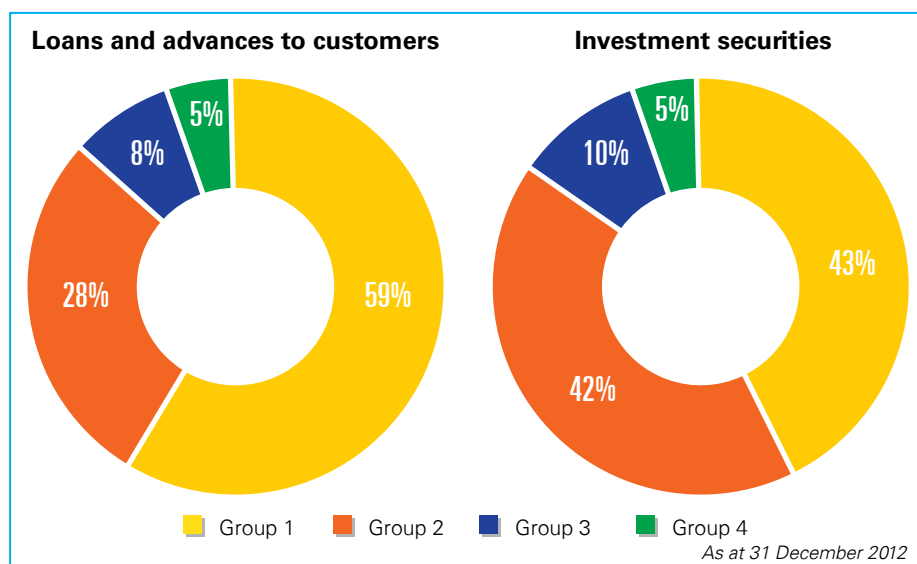


Total assets of Group 1 were nearly 50% of total assets of the 33 banks included in our analysis, Group 2 was above 35% and the balance was Group 3 and 4, together with 15%.

However, Group 2 banks are most active in the interbank lending market with a share of 52% while Group 1 has nearly 35%. The interbank market will be discussed in more detail below.

Group 1 dominated the market of loans and advances to customers (below) with the portion of nearly 60% while the market share of Group 2 was 28%, less than half of the market share of Group 1. This is understandable as banks of Group 1 have been established for a long time and have large branch networks which help them build successful customer relationships across the country.

Groups 3 and 4 comprise 18 banks but account for only 13% of total loans.



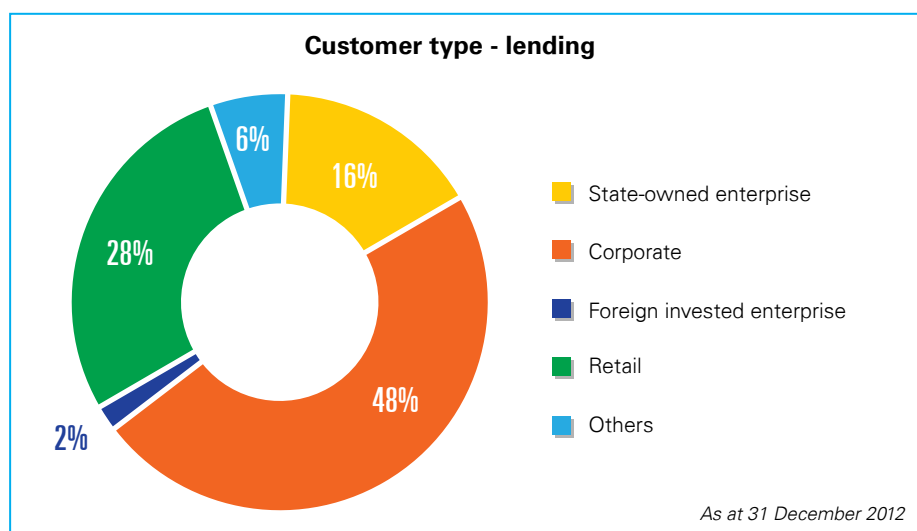
For investment securities, Group 1 and Group 2 had similar position with market share of above 42%. It is therefore interesting to note that the asset mix of Group 2 is heavily weighted towards investment assets, and less towards lending. This investment in Government and corporate bonds may be caused by some banks accepting corporate bonds from some of its customers as an alternative to providing additional loans. Additionally, low credit growth coupled with high deposit growth has provided banks with additional liquidity which drove overnight interbank rates to around 3%. Banks were looking for alternative investment opportunities and the relative safety of Government bonds provided an attractive investment option. It is interesting to note that Government bond yields were below the deposit rates offered by Vietnamese banks for at least the last 2 years. Banks with excess liquidity seemed content to pay high rates and re-invest in bonds until a pick-up in the demand for credit.

Loan analysis

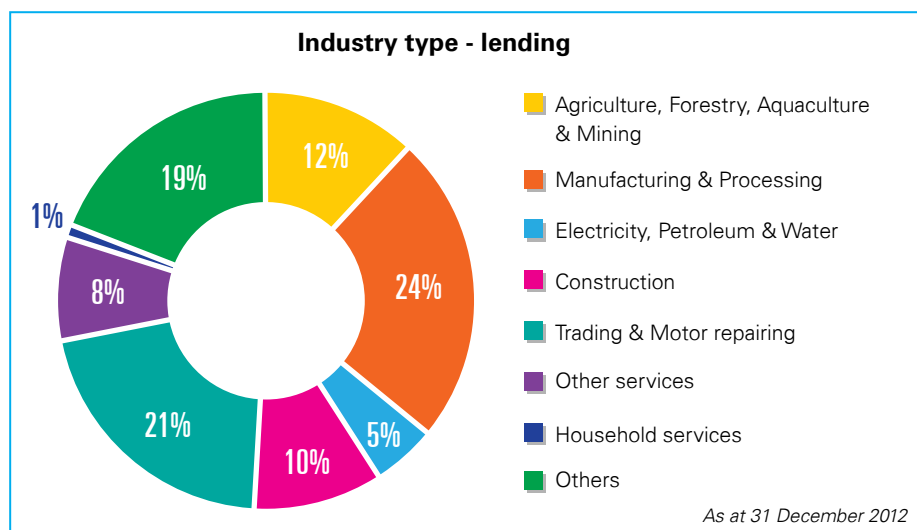
Key findings:

- Corporate lending accounts for nearly half total loans;
- Nearly 25% of all lending is to the manufacturing & processing sector;
- Over 60% of all loans are less than 1 year tenor.

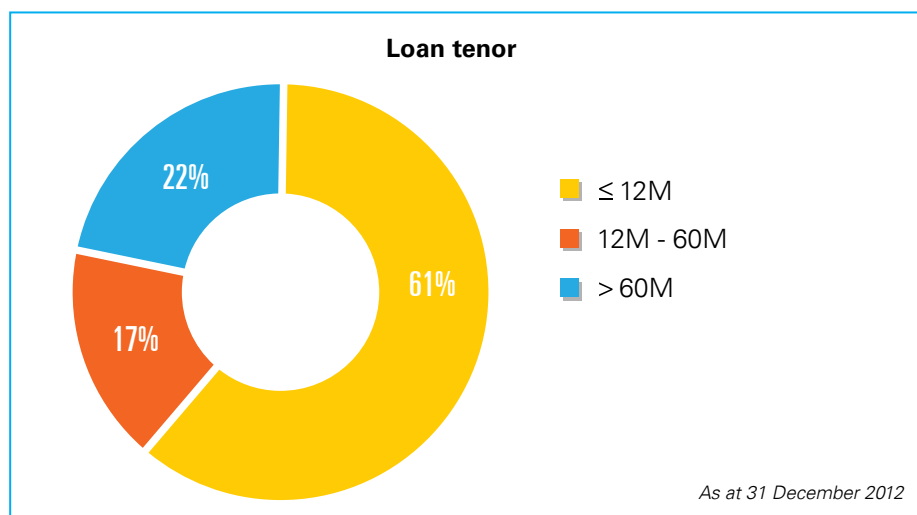
Corporate lending accounted for nearly a half of the total loans outstanding. Nearly 30% of loans outstanding are for retail customers and 16% are for State-owned enterprises. Only 2% of loans outstanding are to foreign invested enterprises, which implies that many foreign invested enterprises borrowed from foreign owned banks and branches.



Vietnamese banks' lending balance concentrates on manufacturing & processing (24%) and trading & motor repairing (21%), then other industries (19%), agriculture, forestry, and aquaculture & mining (12%) and construction (10%).



In terms of tenor, more than 60% of loans outstanding are short term and this portion increased 2% in comparison to 2011. The weaker economic conditions made banks more conservative in giving long-term loans so that the long-term loans decreased 4% from 26% of total loans in 2011 to 22% in 2012.



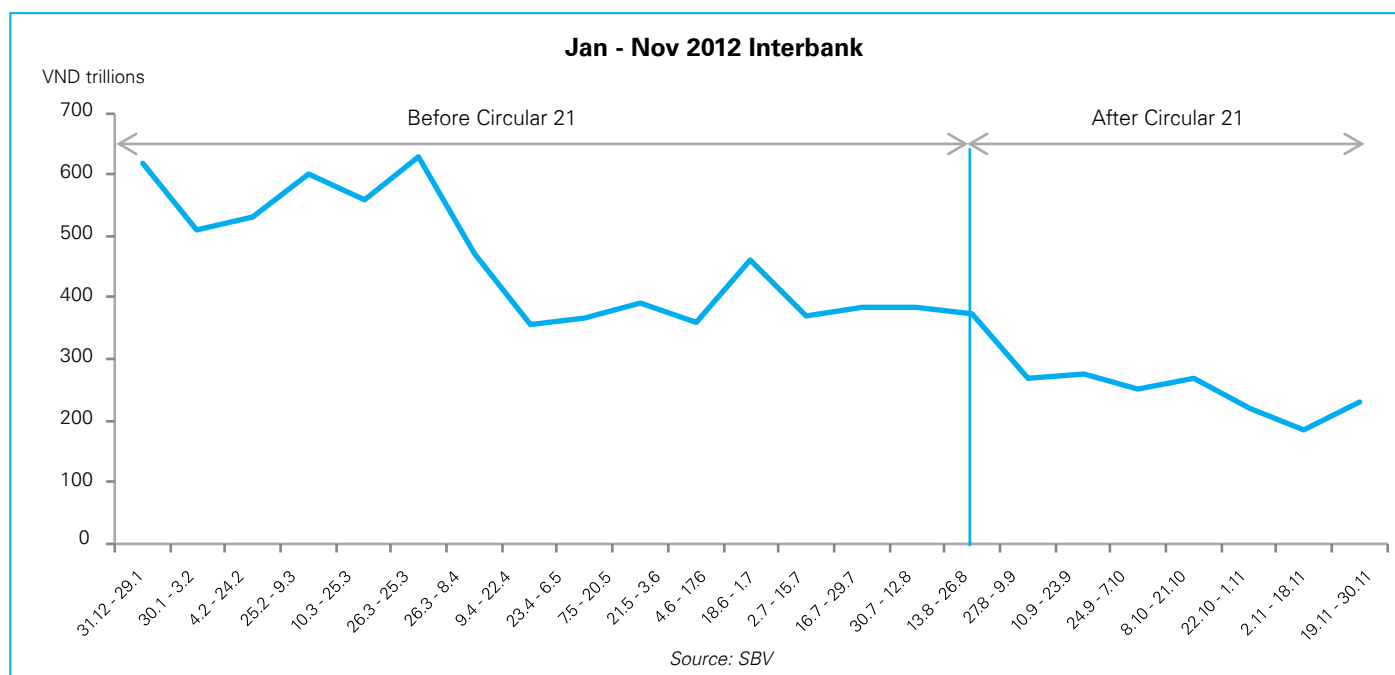
Interbank activities

Key findings:

- Increase in customer deposits means less reliance on Interbank funding;
- New SBV Circular has dampened demand for interbank loans and placements;
- Interbank rates are very low and not commensurate with risk.

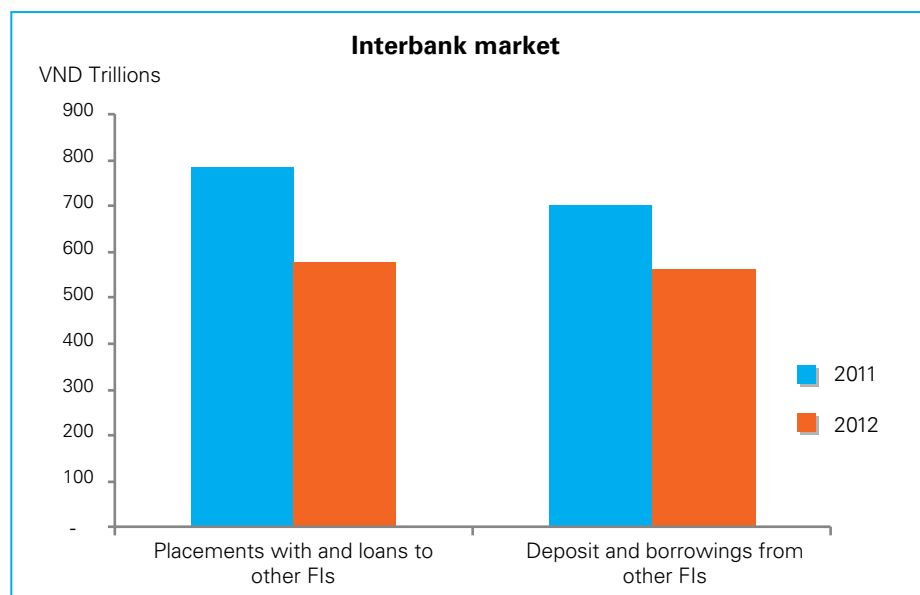
The Interbank market changed significantly in 2012. Volume of interbank activity reduced significantly in 2012 as the increase in customer deposits allowed banks to rely less on interbank financing to fund their balance sheet.

A further contributing factor to the decrease in interbank lending has been the introduction of Circular 21/2012/TT-NHNN (Circular 21) which took effect from 1 September 2012. Circular 21 stipulates that credit institutions can only borrow on the interbank market if they do not have interbank loans overdue for more than 10 days. Interbank lending may be considered a less stable future funding source compared to longer term deposits and the below chart shows the effect on interbank activity before and after the effectiveness of Circular 21.



Additionally, lenders are now required to include a credit provision against their interbank loans making it less attractive for banks to lend to other credit institutions.

Different banks have different credit approval and internal ratings procedures. Along with the uncertainty in economic conditions and future bank merger and acquisition activities, banks are more cautious to lend to other banks, thus reducing the entire system interbank activities. This can be seen in the below chart comparing interbank activity from 2011 and 2012.

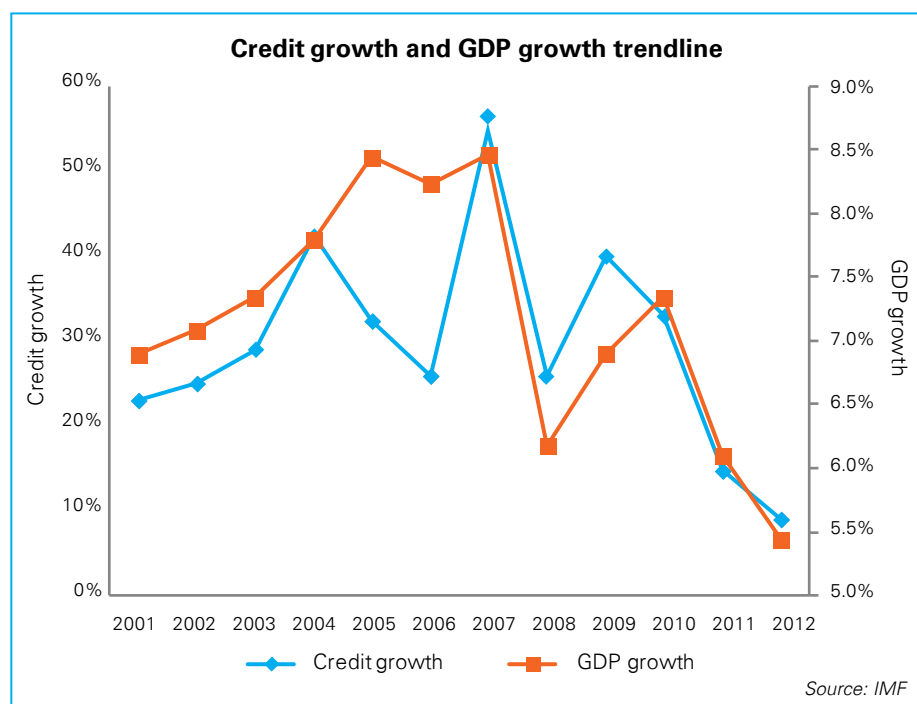


In July 2012 the overnight interest rate on Vietnam's interbank market for VND dipped to 2.5% per annum. Interbank lending at significantly low rates does not reflect inherent default risk and is driven by other factors. Excess liquidity resulting from increased deposits and the inter-connectivity of the Vietnamese banking sector may have been driving factors.

Historical Credit growth

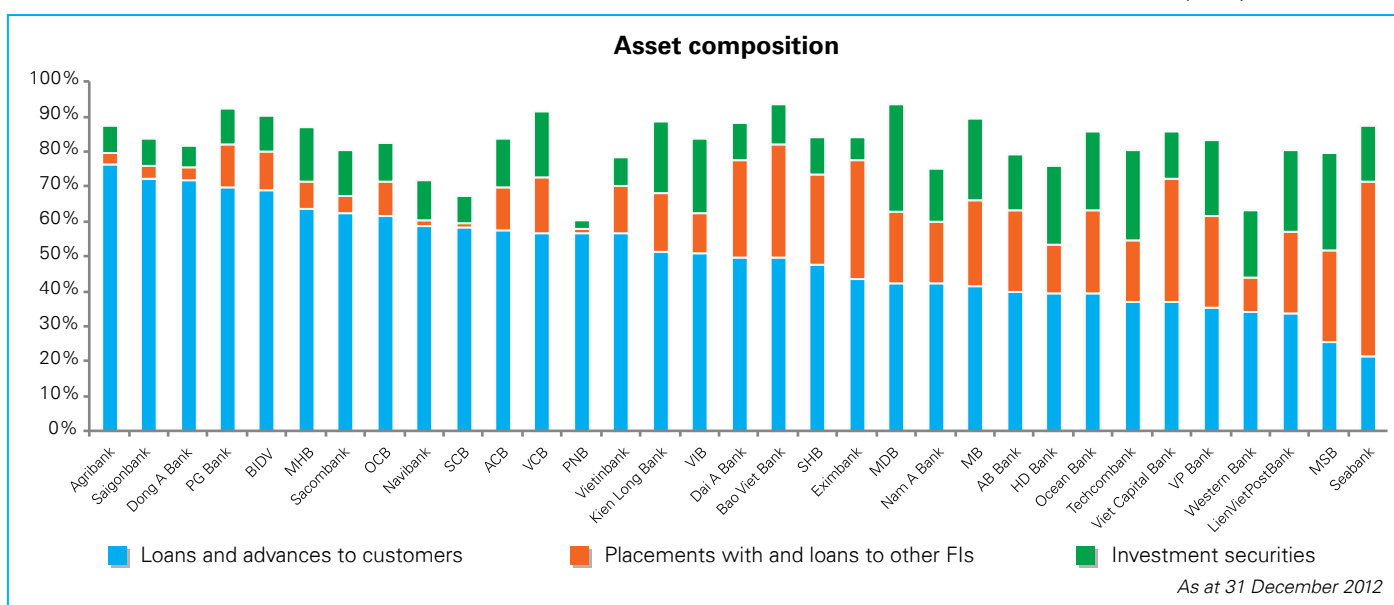
The correlation between GDP and credit growth is unmistakable, as the chart below shows. Higher credit growth is a necessary ingredient to growing GDP, but this comes at a price as credit quality is compromised and higher NPL's result. This is a common feature of emerging markets.

Vietnam's GDP is now growing at the lowest rate since 1999. The SBV has cut rates aggressively during 2013 and we believe that they will now adopt a "wait and see" approach for the remainder of this year. Banks have already lowered lending rates and this should see a significant uptick in credit growth in the second half of 2013.

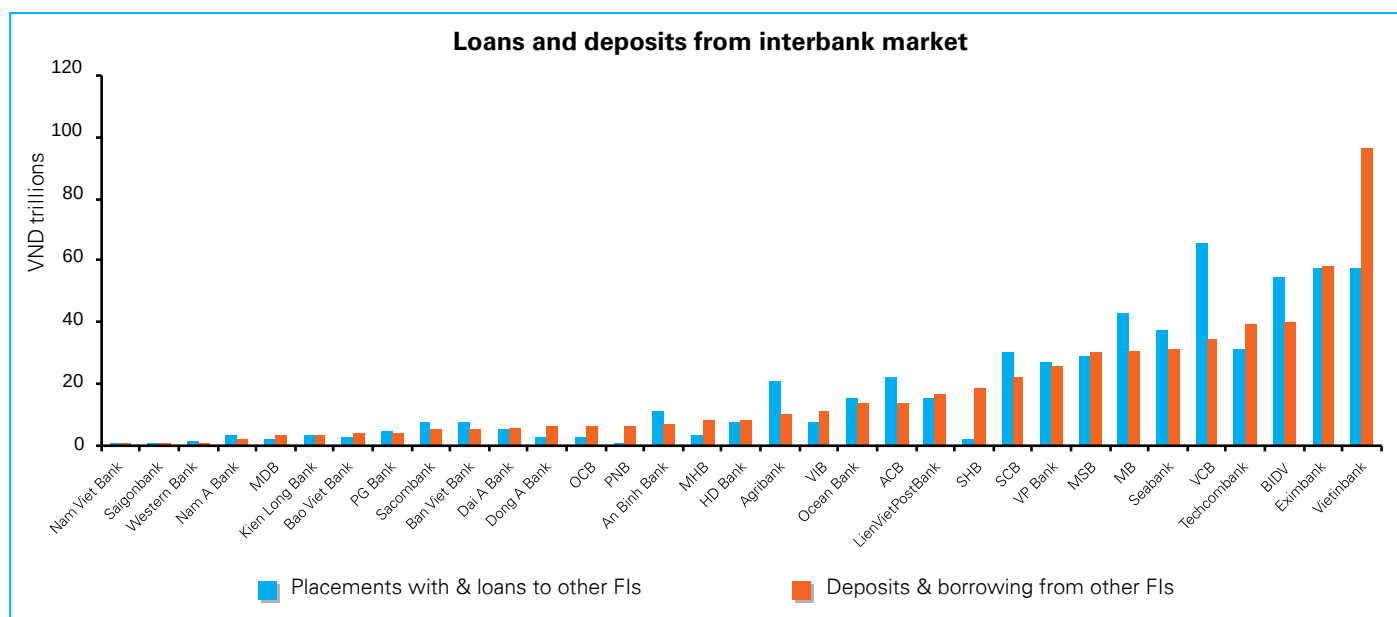


Asset composition of Vietnamese banks

The below chart includes percentages of total assets for the three main asset categories as at 31 December 2012 for the 33 Vietnamese banks included in our analysis. While this chart does not pay attention to the size of the individual banks, it shows there is significant diversity in the composition of Total Assets for different Vietnamese banks. It also does not reflect asset quality.

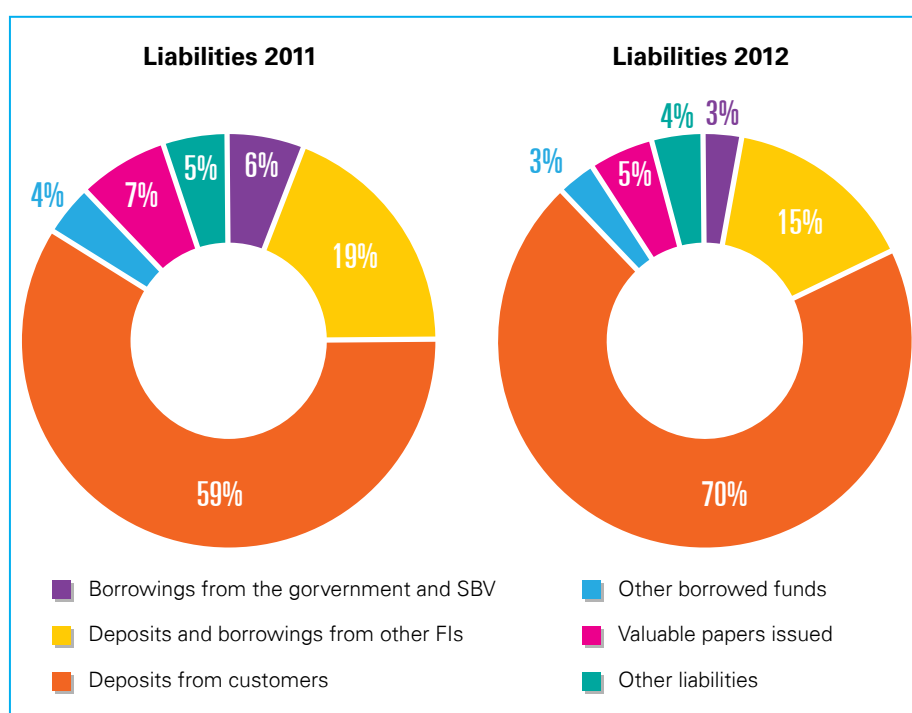


It is interesting to note that loans make up less than 50% of total assets for nearly half of the banks. Given that the two primary functions of commercial banks are to make loans and accept deposits. Nearly 50% of banks had interbank assets above 20% of total assets.



From the chart of interbank market, we can see that the deposit line mostly tracked the loan line. This means the banks borrowed and deposited to one another, “grossing up” their Balance Sheet.

1.2 BANKING LIABILITIES



On the liabilities side, one of the most significant changes for Vietnamese banks during 2012 was the large increase in VND deposits. The VND liquidity issue local banks experienced towards the end of 2011 was resolved due to the high VND interest rates which were imposed to curb inflation that at the time was close to 20%. Investors couldn't ignore VND deposit rates of up to 14% and switched out of USD into VND and this resolved the short term liquidity issue. At the same time it helped stabilize the VND/USD exchange rate as demand for dong significantly increased at the expense of wavering demand for dollars. With USD rates at or below 2%, a significant amount of the conversion to Dong resulted from idle savings kept outside the banking sector.

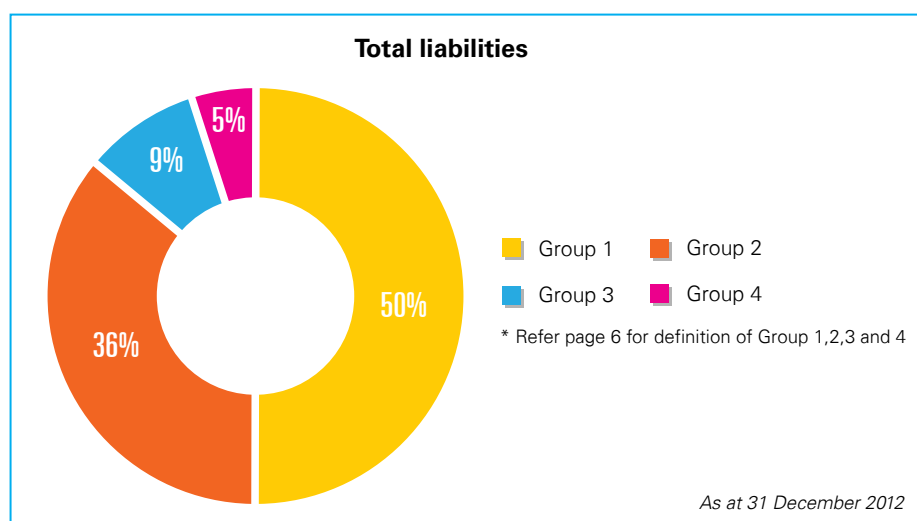
As expected, liabilities from the interbank market also decreased from 19% by end of 2011 to 15% by end of 2012.

The portion of valuable papers issued also decreased from 7% of total liabilities to 5% which again reflected the difficulty of the economy and banking industry as most of valuable papers issued are normally sold to other banks.

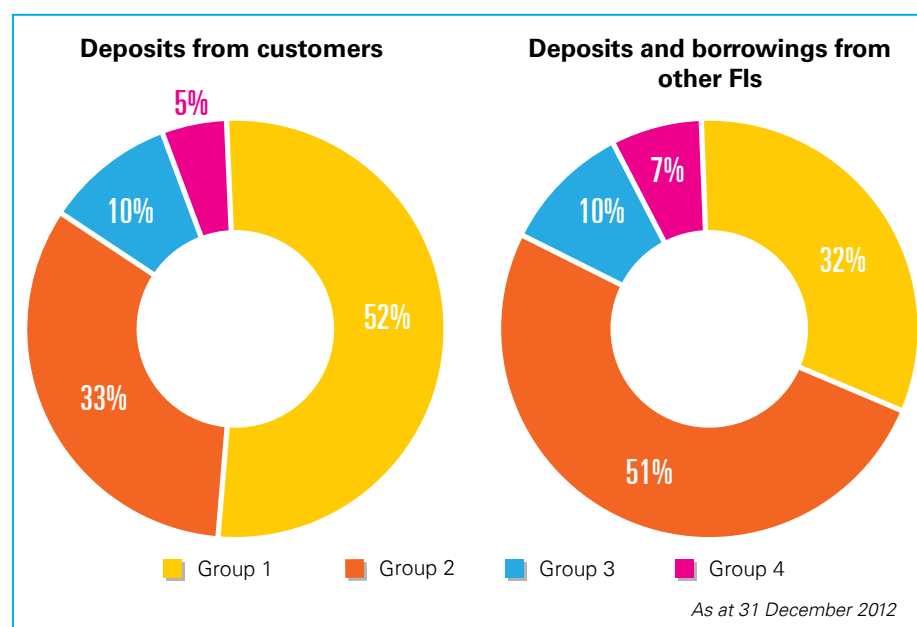
Liability composition across Asia-Pacific					
	Australia	China	Singapore	Thailand	Vietnam
Total deposits	65%	83%	78%	85%	70%
Total interbank	3%	9%	11%	6%	15%
Other liabilities	32%	8%	11%	9%	15%
	100%	100%	100%	100%	100%

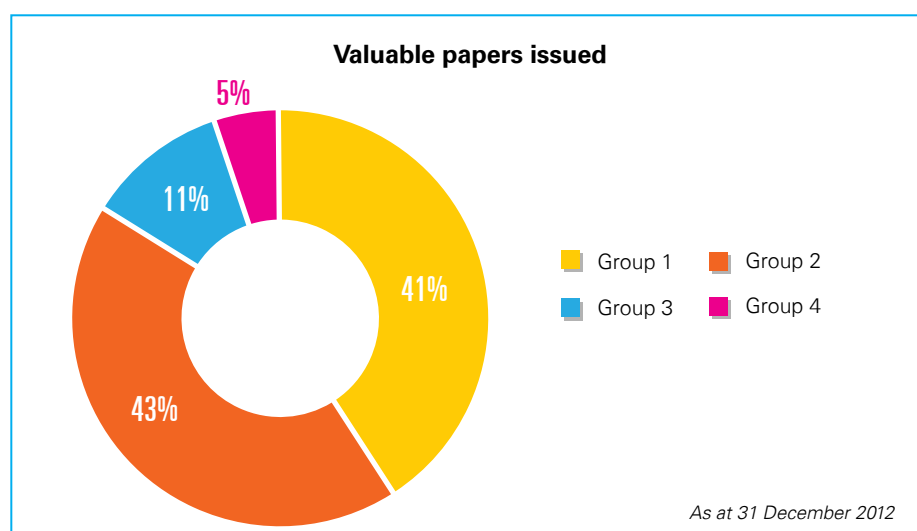
Source: Country Central Bank data and published Annual Reports

Compared with other ASPAC countries, it seems that investors in Asia are quite content to deposit money in banks as an investment choice. Australian banks traditionally have had to borrow offshore to fund the shortfall between Deposits and Loans, and also have large proportion of derivatives included in Other Liabilities.



Similar to Total Assets, Group 1 accounted for 50% of Total Liabilities, Group 2 accounted for 36% and the rest belonged to Group 3 and 4 (9% and 5% respectively). There are however, differences noted in the composition of Liabilities within the different Groups.





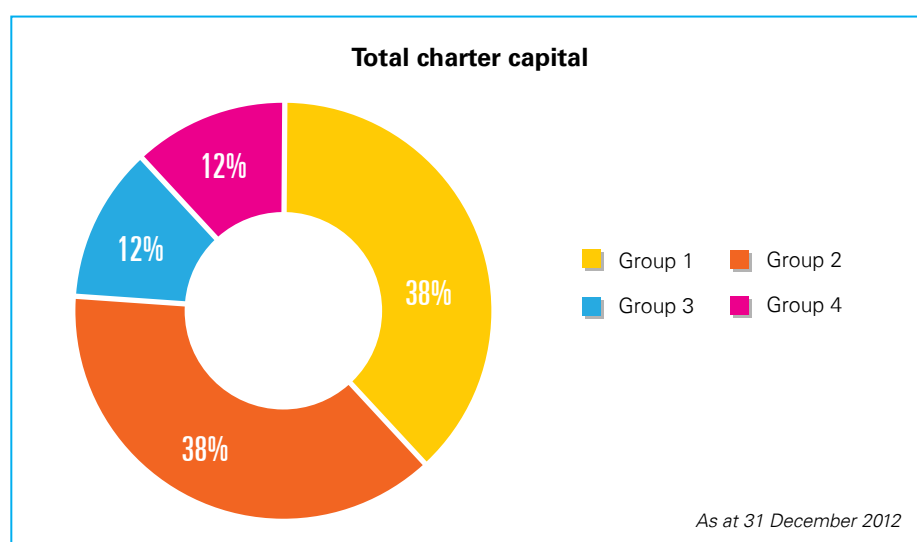
The four Group 1 banks accounted for more than half of the Deposits for the 33 banks included in our analysis, whilst the 11 Group 2 banks contributed 33%. This perhaps reflects the strength and backing of the Group 1 banks, as well as perceived issues with some large Joint Stock Commercial banks.

Notwithstanding that interbank activity reduced significantly in 2012, Group 2 still accounted for more than half of the balances within the interbank deposit market. So while the liquidity issue experienced in late 2011 and early 2012 was resolved, Group 2 banks continue to rely on interbank to fund their lending books.

Interesting to note that Group 3 loans as a percentage of total loans was 8%, but that the deposits as a percentage of total deposits was higher at 10%. This is an unusual anomaly and can perhaps be explained by smaller banks offering higher rates of interest than their competitors. This represents a significant difference for the Group 3 banks.

1.3. CHARTER CAPITAL

Group 1 contains the four State Owned banks and accounted for 38% of total charter capital of the 33 banks in our analysis. Group 2 with 11 members also accounted for 38% of the total charter capital.



2. PROFIT AND LOSS ANALYSIS

Key findings:

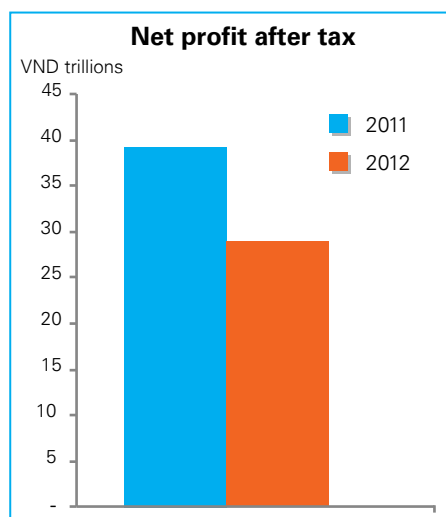
- Net profit fell by 23% year on year, with an increase in operating expenses and increased credit losses being the main causes;
- Inconsistent performance in smaller banks;
- Personnel costs is the largest component of operating expenses, with increasing headcount across the banking sector;
- Reported NPL of 4.67%.

Profitability in 2012 saw a moderate decrease across the entire banking sector, with only a few exceptions. We present below the analysis of some key performance metrics for 33 domestic commercial banks in Vietnam.

2.1. NET PROFIT

Key findings:

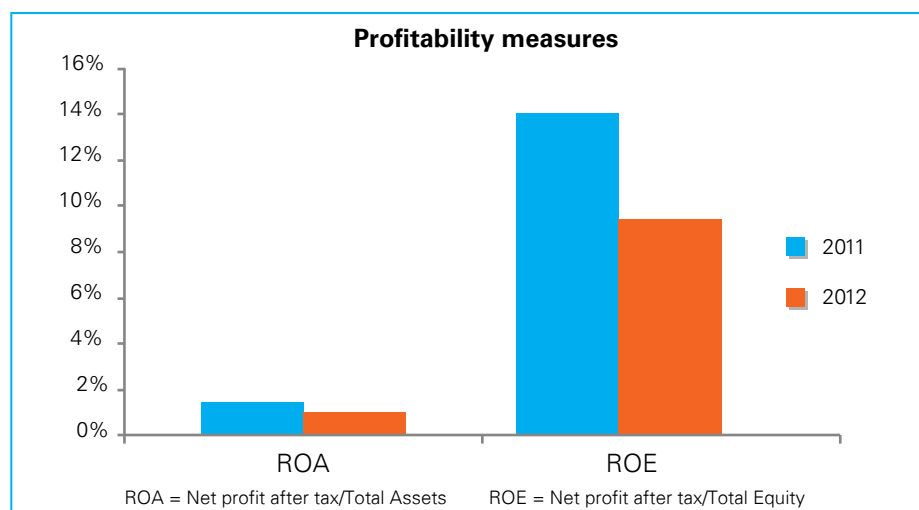
- 2012 Net profit after tax is VND 31 trillion, representing a 23% decrease on 2011;
- 2012 ROA was 0.78%, down from 1.06% in 2011 (decrease YoY of 27%);
- 2012 ROE was 9.56%, down from 14.19% in 2011 (decrease YoY of 33%).



Net profit across the banking sector fell 23% to VND 31 trillion compared to 2011 (VND 40 trillion). This significant decrease is mainly attributable to the increase in credit losses and operating expenses, which is addressed below in a separate analysis, and the decrease of net interest income.

Due to the difficult economic environment in 2011-2012, businesses continued to suffer difficulties in 2012. Businesses which were already facing difficulties in 2011 experienced worsening conditions in 2012 while businesses which were operating satisfactorily in 2011 faced a very challenging 2012. Therefore, banks had to account for more provision as the quality of the loan portfolio worsened.

Additionally, whilst most businesses did not borrow more and kept operations at the same capacity, banks became more reluctant to lend due to increasing NPLs.



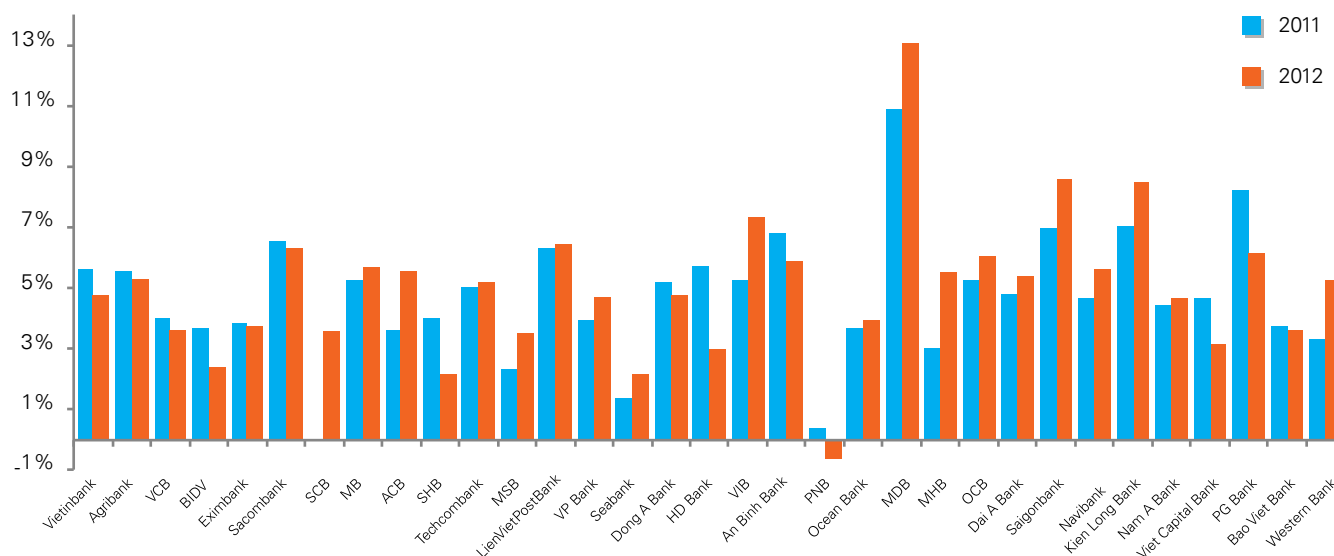
Both average ROA and ROE of Vietnamese local banking system in 2012 decreased in comparison to 2011 as the chart above. ROA fell by above 27% from 2011 to 2012 and nearly 33% for ROE. Within 33 banks, only two banks had both ROA and ROE increased while eight banks had both ROA and ROE reduced by at least 50% each in 2012 compared to 2011.

2.2. NET INTEREST MARGIN (NIM)

Key findings:

- Net interest margin slightly increased across the sector;
- Only one bank incurred net interest loss;
- MDB has the highest NIM in 2012 and 2011 (13.08% and 10.93% respectively);
- Smaller banks tend to have higher NIM.

Net interest margin in commercial banks



Smaller banks tend to have higher NIM (Group 4 banks are at 5.68% when Group 1 banks are at only 4.01%). Larger banks appear more conservative on credit approval and smaller banks target SME and other retail and may accept higher risk. At the same time, deposit interest rates across the banking sector have been relatively consistent as the SBV has been regulating the deposit interest rate cap at 14% in 2012 and now down to 7% in 2013.

We didn't observe any significant fluctuations within and across Group 1 and 2, while Group 3 has some significant inconsistencies in NIM, ranging from -0.65% to 13.08%.

Despite being an effective operational performance indicator, NIM does not fully reflect banking sector profitability. A bank's profitability is affected by its unique profile, i.e., the nature of its activities, the composition of its customer base, and its funding strategies. No two banks are the same, and this is especially true across the Vietnamese banking sector. On one end of the range, the widest and most favorable NIM's are generally found at banks with traditional lending and deposit businesses. On the other hand, some state owned banks are able to operate effectively with lower NIM's because of the size of their operations.

NIM did not take into account the service fees and other non-interest income and operating expenses, such as personnel and assets costs, or credit loss expenses, and therefore could not fully reflect banking sector profitability. We will address these issues in our following analysis.

2.3. NON-INTEREST INCOME (NII)

Key findings:

- NII represents 14% of operating income (Net Interest + Non-Interest Income);
- Group 1 is the only group that established consistent NII ratio at 19%;
- Mixed and inconsistent performance across all other banks;
- Fees and commission income is the largest component of NII.

A breakdown of the 14% NII is as follows:

- Net fees and commission income: 6.47%;
- Net gain from foreign currencies and gold trading: -0.70%;
- Net gain from dealing of trading securities: 0.44%;
- Net gain from dealing of investment securities: 1.10%;
- Net other operating income: 5.99%;
- Income from long-term investments: 0.99%.

Non-interest income compared to other ASPAC countries

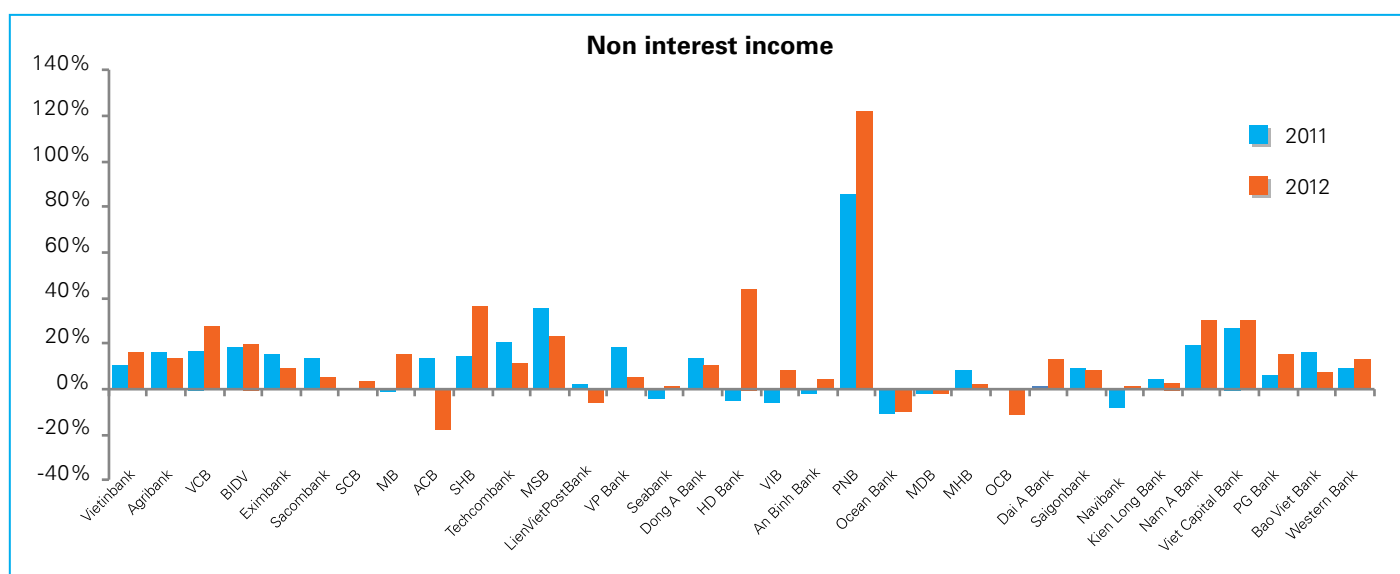
	Australia	China	Singapore	Thailand	Vietnam
Non-interest income ratio	33%	21%	40%	36%	14%

Source: Country Central Bank data and published Annual Reports

Compared to other ASPAC countries, Vietnam banking sector's NII ratio is relatively low. One of the main contributing factors is that the estimated retail penetration is around 15%. In more developed countries, the penetration of banking services is significantly more developed. For example, in Australia, banks actively monitor the percentage of "Customers with 4 Products" and even "Customers with 8 Products". Retail accounts are one of the main sources of fees for products such as mortgages, credit cards, and everyday accounts, and these products are not widely used in Vietnam, compared to other countries.

Additionally, local equity markets experienced a difficult 2012 and tight control of the USD/VND rate create limited opportunities for banks to trade FX.

Despite being lower than regional practice, NII in 2012 saw a 7% increase compared to 2011 and we expect to see greater increase in 2013, especially when all respondents for our survey stated that their banks would offer new services in 2013.



2.4. OPERATIONAL EXPENSES

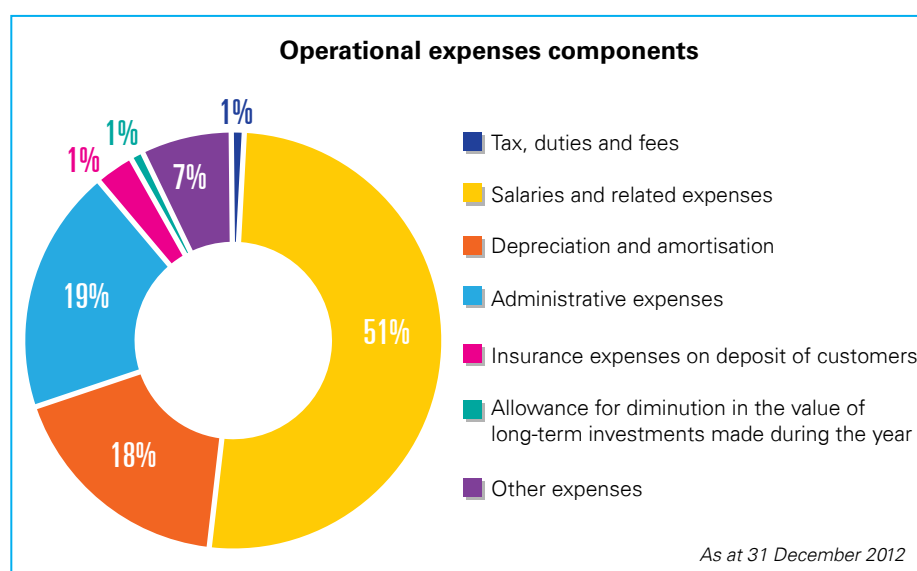
Key findings:

- Operational expenses increased 14% in 2012 ;
- Operational expenses takes up to 49% of total operating income;
- Only two banks managed to cut costs in 2012;
- Salaries and related expenses continue to be the largest component of operational expenses.

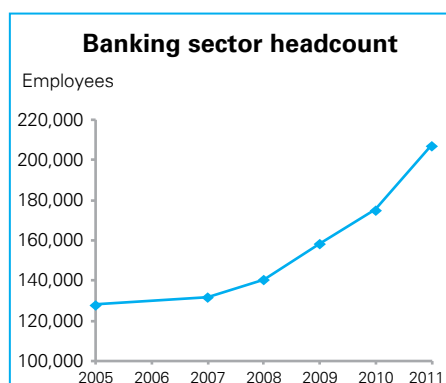
Operational expenses increased overall in 2012 despite banks' intention to cut costs. Operational expenses represent up to 49% of total operating income of the 33 banks included in our analysis and for 20 banks are more than 50% of their total income. Compared to banking practice in other ASPAC countries, Vietnamese banks incur the highest operational expenses relative to operational income, and there is a need to look for methods to reduce costs.

	Australia	China	Singapore	Thailand	Vietnam
Operational expenses	42%	40%	38%	44%	49%

Source: Country Central Bank data and published Annual Reports



Salaries and payables to employees accounted for around 50% total operational costs and were the largest component of operational expenses. This movement is opposite to current global trends where the employee costs as a percentage of operational costs have decreased to below 40%.



As shown in the graph the number of employees in the banking sector has been increasing. Despite recent articles on certain banks' layoff plans, we expect the banking sector headcount to keep increasing in 2013. Our expectation is also consistent with our findings above regarding personnel costs and operational expenses. Retail customers always demand more products, better services along with new offers and promotions. Moreover, as the economy is recovering, business customers will be looking to get new loans and expand their operations. Therefore, domestic banks are under pressure to expand their coverage and improve their customer services. On top of that, foreign banks are gaining traction in an already competitive market. Domestic banks must find the fastest way to capture a larger share of the market: to have more branches and offices, therefore, more staff.

This movement is going against global trends as global banks are downsizing to cut costs. We can expect the number of banking sector staff in Vietnam to continue to grow, albeit at a slower pace.

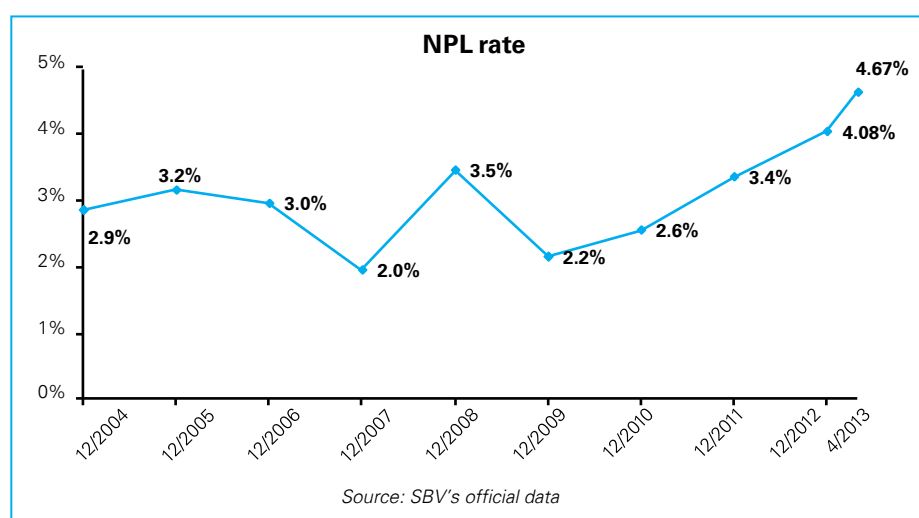
2.5. NONPERFORMING LOAN (NPL)

The results and analysis reflect the entire banking sector. Key findings:

- Reported NPL across banking sector is 4.67%;
- Credit loss expense has increased significantly in recent years.

Reported NPL across banking sector has been increasing since 2009 and is 4.67% as of April 2013. Independent rating agencies as well as other economists believe the 'unreported' number to be much higher. Many think that the 4.67% of NPL doesn't reflect the true troubled status of Vietnamese businesses, or of the credit quality of bank lending.

The SBV has issued many measures to control and manage NPL at commercial banks, such as issuing Circular 02 on loan reclassification (effective June 2014) and establishing VAMC (Vietnam Asset Management Company) to repurchase banks' NPLs to assist banks on NPL resolution.



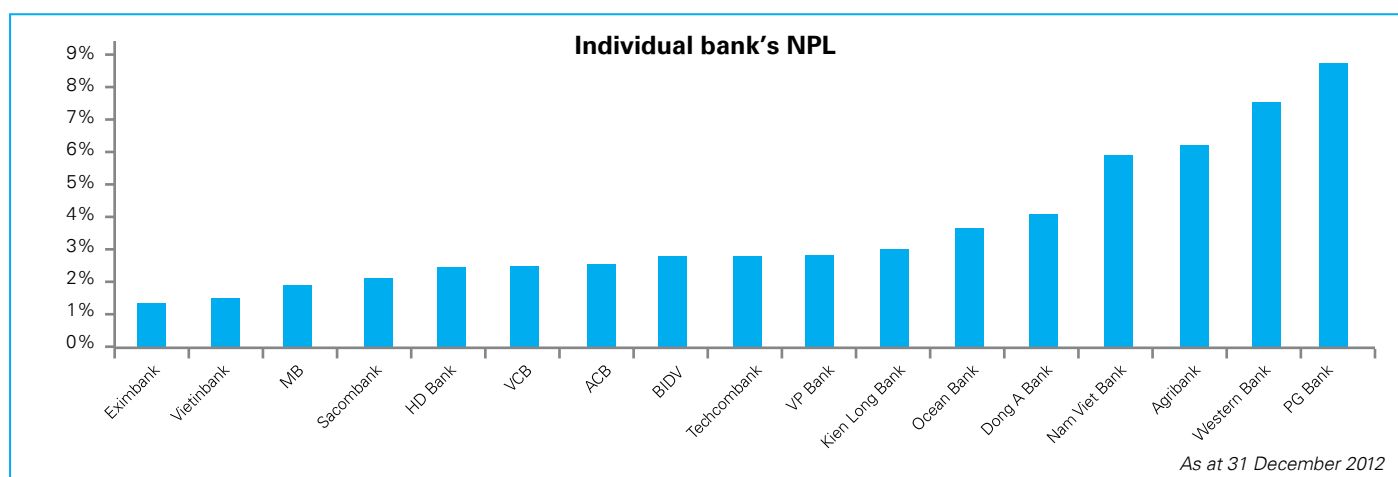
Which much attention focused on NPL, it would be worthy to take a look at the many external and internal causes of credit risk. External factors are outside the control of the bank, so banks need to focus their efforts on dealing with the internal factors.



What causes Credit Risk for a bank?	
External Factors	Internal Factors
Macroeconomic Factors	Poorly designed Credit Models
Legal Environment	Portfolio Concentration
Fraud	Fraud
Operating Environment	Lack of Credit Governance
	Insufficient Monitoring process
	Due diligence failures

The #1 cause of Credit Risk is “poorly designed credit models”, and our Banking Survey results presented in the next section reveal that less than half of Vietnamese banks included in our survey are satisfied with their current internal ratings models. The deficiencies in the current model stem from their unbalanced weightings of “quantitative” and “qualitative” factors. Additionally, there is no separate model for SME or FI and no link between credit rating and pricing. Models need to be tailored to suit the risk appetite and the strategy of the individual bank.

For the 33 banks included in our analysis, just over half reported NPL numbers in their 2012 Annual Reports. These are reproduced in the chart below.



Comparative country information included in the tables in this report has been extracted from both published data from the Central Banks of those countries, or from a representative sample of published Annual Reports from significant banks in those countries.



PART 2:

KPMG BANKING SURVEY

Against the backdrop of a fast changing regulatory environment, as well as a still-sluggish overall economy, nearly 70% of the banking executives in Vietnam who participated in the KPMG 2013 Banking Survey say they expect economic conditions in 2013 to be no better or worse than in 2012. At a Banking sector level, revenue growth, risk management enhancements and internal credit ratings improvements are at the top of their agenda this year.

Given those conditions and priorities, the bank executives say they will continue to focus on growing the top line, increase spending in risk management initiatives, especially around credit and IT infrastructure, and will be less likely to be involved in a merger or acquisition (M&A) than they were a year ago.

KPMG sent two questionnaires to many of the largest banks in Vietnam. We received completed responses from slightly more than two thirds of the banks and the results to the survey questions have been tabled in Parts 2 & 3.

The first questionnaire contained questions about the bank itself and sought the views of management on the banking sector. The second questionnaire asked specific questions on their banks preparedness for Basel II. Not all questions and responses have been included in the Survey results presented in Parts 2 & 3.



KEY SURVEY QUESTIONS AND ANALYSIS

1. Is the State Bank of Vietnam sufficiently pro-active on banking system reform?

Yes	No	Not Sure
67%	20%	13%

The State Bank of Vietnam is viewed by two-thirds of survey respondents as being sufficiently pro-active on banking sector reform. Indeed the SBV has released or been very involved in a litany of important laws and regulations such as Circular No. 02/2013/TT-NHNN on bad Debt Classification, new Anti-Money Laundering/Counter-Financing of Terrorism Laws 07/2012/QH13 effective from 1 January 2013 and Circular 44/2011/TT-NHNN regarding the System of Internal Control.

Regulators play a pivotal role in molding the landscape for banking processes, functions and reporting. While there have been numerous new SBV regulations to strengthen the banking sector, some observers note that there is room for further improvement. For example, the Financial Action Task Force (FATF) recently commented on Vietnam's new AML/CFT rules by saying that while Vietnam has taken steps towards improving its AML/CFT regime, the country has not made sufficient progress in implementing its action plan, and certain strategic AML/CFT deficiencies remain. Some market participants also commented that the SBV could take a harder line on enforcing new laws and regulations, such as AML.

Additionally, it was announced in April 2012 that the SBV would introduce a Basel II type risk-based supervisory approach over the next five years. While a consultant has been selected to oversee the initial stages of this project, there has been little further comment or status updates on this initiative.

2. Do you think it is possible to have around 15 – 17 domestic banks by 2015?

Yes	No	Not Sure
7%	67%	26%

A strong banking sector is an essential ingredient for any developing country. The Government and the SBV are aware of this and late in 2011 launched the banking sector restructuring plan to reform the country's banking system by 2015. Part of the reform plan was to consolidate the sector, reduce the number of small and weak credit institutions and restructure/establish some large banks and the initially expressed aim was to have 15 -17 Vietnamese banks by 2015. There have been some successes, most notably the merger of three small Ho Chi Minh City based banks to form Saigon Commercial Bank, the merger of SHB and Habubank and the proposed cooperation agreement between Sacombank and Eximbank but overall progress has been slow and there are still more than 40 domestic Vietnamese banks. It is not easy to integrate banking institutions due to the complexities involved in combining people, processes, technology, branches and brands. Moreover, Vietnam has experienced yearly increases in the number of banks since 1992, so there is lack of on the ground "know-how" regarding consolidating the sector via bank tie-outs.

Additionally, there are the issues of capital weakness, high NPL's and inadequate risk and reporting systems. There appears to be reluctance from banks to accept mergers due to lack of financial transparency, and as there is a belief that there must be winners and losers in the process. The success of the Government's banking reform plan will be a key platform for Vietnam's future sustainable growth.

3. Are you expecting headcount at your bank to increase in 2013?

Yes	No	Not Sure
54%	46%	0%

More than half of the banks surveyed expect an increase in headcount in 2013 and in a number of cases this is due to the opening of new branches which have been licensed from last year. Part 1 of this report included a chart named "Banking sector headcount" highlighting the strong growth in the number of bank employees over the last seven years. We are therefore surprised that nearly half of the banks in our survey did not expect to increase headcount in 2013.

The increased headcount trend of Vietnamese banks is opposite to the global trend. International banks now focus on streamlining products and services through the use of new technologies, such as internet banking and mobile banking which do not require physical branches to widen customer networks. In Vietnam, the banking technology products and services are still being developed and most existing customers have never experienced these products or services. Recent issues of losing money on internet banking make customers more cautious to use internet and mobile banking. The IT security company Kaspersky Lab recently ranked Vietnam among the top five countries being targeted by fraudsters to commit internet banking fraud. This is driving an increase in face-to-face interactions between bank and customer and therefore an increase in bank staff.

Additionally, it is estimated that only 15% of Vietnam's population has a bank account, so banks are trying to increase organic market share through accessibility and market education. This requires additional headcount. However, nearly 90% of banks who expected to see headcount increase said that headcount would only grow slightly.

4. Has your bank revised AML Policies to comply with the new Law on Anti Money Laundering No. 07/2012/QH13 which became effective 1 Jan 2013?

Yes	No	Not Sure
73%	7%	20%

Money laundering through financial institutions has been an increasingly important issue for banks and regulators over the last few years. In 2012 numerous global banks agreed to pay record fines for prior breaches of AML rules, some in excess of \$1 billion.

Recent two examples show how easily banks can become a medium for money laundering and how serious foreign regulators are in preventing and eliminating this criminal act. The recently introduced Laws 07/2012/QH13 show how serious the Government is in playing its part to combat AML.

We are somewhat surprised however that 73% of our survey respondents answered that their bank has already revised AML policies. KPMG in Vietnam have been engaged by some proactive banks to conduct a diagnostic review of their AML policies and procedures and to understand the compliance gap with the new AML laws. We notice that all of these required assistance and support to amend policies, implement process changes and train staff to comply with the new AML Laws.

5. Does your bank comply with FATCA?

Yes	No	Not Sure
33%	13%	54%

FATCA is the Foreign Account Tax Compliance Act. It is a far reaching piece of US legislation that will impact most banks in Vietnam. FATCA becomes effective from 2014 and is designed to prevent and detect offshore tax evasion by US taxpayers. To do so, FATCA sets out a comprehensive and complex set of rules which will impact almost every financial institution around the world. Banks, fund managers and other institutions failing to comply with FATCA could effectively be forced out of U.S. financial markets, or stopped from investing in US assets. Over half of our survey respondents were unsure about the banks FATCA compliance status.

With the enactment of FATCA, FFIs (Foreign Financial Institutions) generally must conduct strict due diligence on their account holders and investors to determine whether their accounts are "US accounts". Additionally, FFIs will face a choice of whether they will sign an FFI agreement and agreed to identify and report to the US tax authority, the Internal Revenue Service (IRS), information about direct and indirect US account holders, or be subject to 30% withholding tax on all direct or indirect US source income.

It is surprising that some Vietnamese banks in our survey indicated they currently comply with FATCA as we are not aware of any bank across the ASPAC region that has already fully complied with FATCA requirements.

Many of the foreign banks operating in Vietnam have commenced FATCA projects and KPMG in Vietnam has been engaged to assist with their local compliance requirements.

6. Compared to one year ago, how do you feel about the financial prospects for your bank?

Very optimistic	Quite optimistic	Quite pessimistic	Extremely pessimistic
7%	73%	20%	0%

7. At your bank, how are Revenues likely to change over the next 12 months?

Significant increase	Slight increase	Slight decrease	Significant decrease
7%	80%	13%	0%

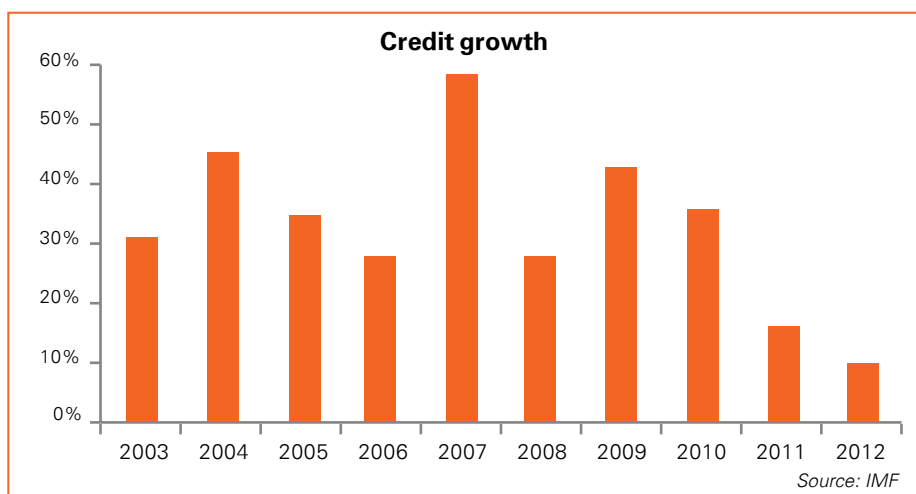
Vietnamese bank management is overall quite optimistic about the financial prospects of their banks and their revenues in the near future. This is a positive outlook given that 70% of respondents believed economic conditions will deteriorate in 2013 compared to 2012. The banking sector experienced a very challenging 2012, with slower credit growth, lower NIM's and higher operational expenses resulting in a 23% reduction in profitability compared to 2011.

However, Vietnam's economic condition is showing positive signs of a recovery. At a macro level, inflation appears under control; interest rates have come down and the dong has stabilized under the watchful eye of the SBV. Moreover, the SBV has been very pro-active on banking sector reform and the Government is taking active measures to restore confidence to the property market coupled with preferential lending to growth sectors. Therefore, banks have many reasons to believe that business conditions are improving going into the latter part of 2013. Moreover, 100% of our respondents said that their bank would have new products, offers and promotions in 2013. We believe local banks' expectations of their financial prospects are reasonable and achievable.

8. Do you expect Credit growth at your bank to exceed 10% in 2013?

Yes	No	Not Sure
80%	20%	0%

In 2012, the SBV divided domestic banks into four groups and applied maximum credit growth (17%, 15%, 8% and 0%) to the banks in each group. However, the actual credit growth of whole banking industry in 2012 was 8.91%, and this varied significantly from bank to bank.



In 2013 the SBV again assigned credit growth targets for each bank. While this information is not public, it is reported that there were three groups with targets of 12%, 9% and 5%. Additionally, it is understood that exceptional approval was provided for some banks to grow at much higher rates. The fact that targets for 2013 are lower than last year is a signal that the SBV expects that economic conditions may not improve significantly in the current year.

Since the respondents to the banking survey tended to be from the larger Vietnamese banks, credit growth of above 10% is achievable in consideration of actual credit growth of nearly 9% of whole credit system in 2012. Figures released by the SBV on 30 July 2013 showed that total outstanding loans in the country's banking sector increased 4.91% in the first six months of 2013. Interesting to note that deposits over the same period increased by 9.48%.

9. Are you satisfied with the quality of Risk Management at your bank?

Yes	No	Not Sure
64%	29%	7%

Respondents were generally complimentary of their banks quality of risk management. Banking executives were asked to identify specifically which risks were well managed and which weren't. Controls and process around managing liquidity risk received the highest praise (79%), while there was most concern around operational risk (57%). Credit risk and market risk was between these two results. We believe this is because liquidity risk stresses in the market two years ago were quickly resolved and also centralized at head office. Management of other banking risks has only recently been centralized but with long standing process and control deficiencies.

10. Are you satisfied with your current internal credit rating system?

Yes	No	Not Sure
47%	40%	13%

The primary cause of credit risk is poorly designed credit models and less than 50% of banks are satisfied with their current models. Nearly all banks in Vietnam use similar internal ratings models that were generally developed four or five years ago. Many banks in Vietnam have lost confidence with their models because they approved loans to weaker borrowers that could not repay and this has contributed in part to the high level of NPLs.

Additionally, very similar models were implemented at almost all banks. The local banking sector has numerous sub-categories of banks, so the same model should not be used for a big state-owned bank and a small joint stock bank because they have different strategies and are focused on different customer segments. Models need to be tailored for each bank according to strategy, and the specific weightings need to be amended according to the risk appetite of each bank. Additionally, there is no established methodology locally for FI credit ratings and this should be considered in light of the high level of interbank activity in Vietnam.



11. At your bank, how will spending on Risk Management initiatives/ framework change over the next 12 months?

Significant increase	Slight increase	Slight decrease	Significant decrease
20%	73%	0%	7%

Risk management in Vietnam has never had greater exposure. Local banks recognize the connection between risk management and profitability however, risk management remains a new function for Vietnamese banks who are still struggling to identify risk appetite, risk tolerance and risk limits, as well as how to strengthen processes, controls and resources.

Establishing sound risk management processes that are relevant and applicable for Vietnam will take time. It is encouraging that nearly all banks in our survey will enhance their risk management capabilities over the next 12 months.

12. At your bank, how will spending on developing better Credit Risk Management processes change over the next 12 months?

Significant increase	Slight increase	Slight decrease	Significant decrease
27%	67%	0%	6%

Managing credit risk has a longer history in Vietnam compared to other risks, but it remains top of mind for bank Boards and senior management. Global banks attribute more than 80% of their regulatory capital for credit risk, with the remainder allocated to cover operational risk and market risk. Managing credit risk effectively is therefore paramount to the longevity of any bank and to achieving sustainable profitability.

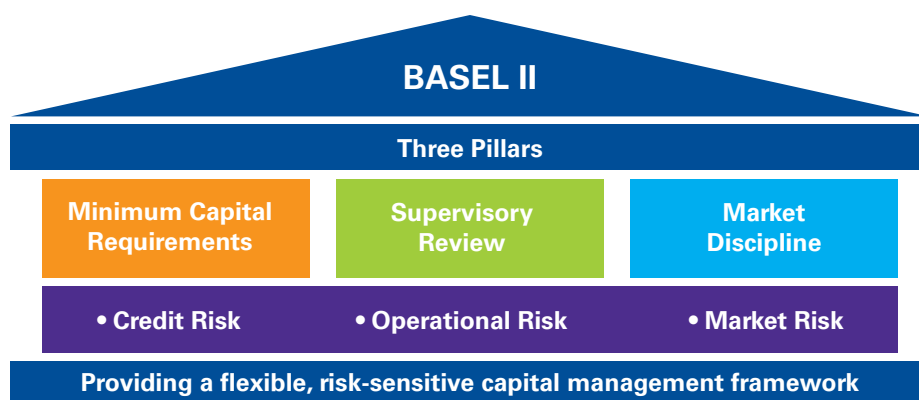
Nearly all banks included in our survey said that they would allocate more money to credit risk management. Given our credit experience in other markets, as well as in Vietnam, KPMG believe there is room for local banks to enhance controls especially around the credit assessment and due diligence, establish preventative and detective controls covering approvals and fraud, implement monitoring processes such as early warning systems, improve collection processes and to refocus the work plans of internal audit to validate that processes are working as they should.



PART 3:

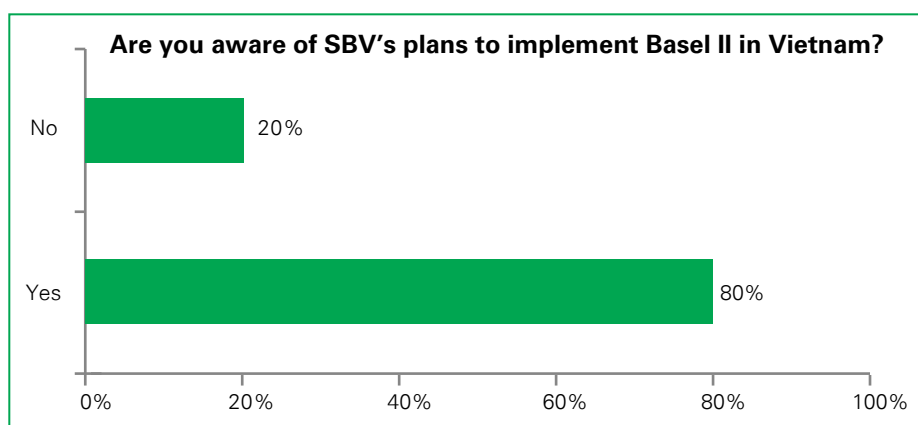
EVOLVING BASEL REGULATION

In 2012, the SBV embarked on a program relating to the implementation of a “Basel II type” risk-based supervisory and regulatory approach in Vietnam. Numerous challenges lie ahead, not the least of which is anticipating what the actual regulatory requirements around capital will be and how that will affect bank processes.

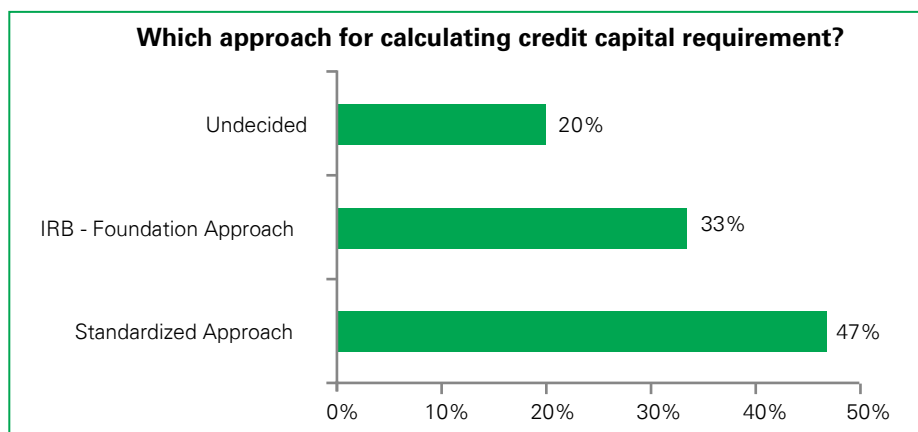


Most banks (80%) are aware that the SBV plans to implement a Basel II type supervisory framework. The SBV has sponsored training courses to introduce Basel II implications for Vietnamese banks but, given no guidelines on the expected rules have been released, banks are unwilling to commit to a roadmap and make important decisions that may be costly to implement.

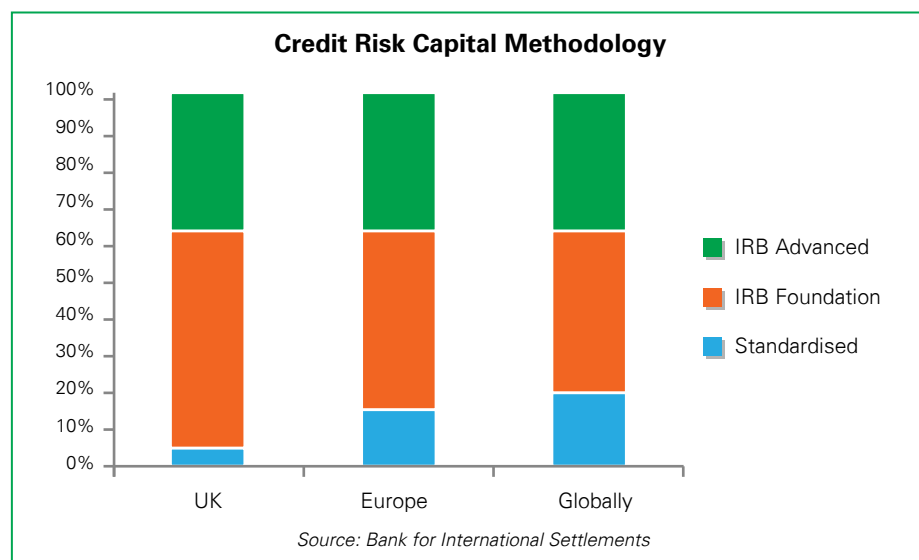
More than half of the respondents have established Basel II implementation teams and most of the banks plan to apply Basel II for all credit, operational, market and liquidity risks.



For credit risk, nearly half the banks (47%) said they will use the standardized approach for calculating the capital requirements. The IRB foundation approach is favored by 33% of banks and only 20% have not yet decided the method of calculating their capital requirement for credit risk.



The Bank for International Settlements (BIS) recently reported the preferred methodology for calculating risk capital applied by banks from its 47 member countries. It is interesting to note that whilst that standardised approach is the easiest to implement and not that different to Basel 1 (1988), less than 20% of banks use this approach compared to the 47% above for banks in Vietnam. Additionally, no bank chose the IRB Advanced method, which has been applied by nearly 40% of banks from BIS Member countries.



For operational risk, 64% of banks will use the standardized approach for capital calculation while 14% of banks use Basic indicator method and 21% have not yet decided. These results are very similar to the banks around the world already complying under Basel II.

However, nearly 80% of banks think that their approach would be changed in next five years for both credit and operational risks. All banks indicated there were many difficulties in implementing Basel II. The two most common difficulties reported by our survey participants were the expected costs of Basel II implementation (85%) and a lack of historical data (78%).

Basel II (2004) was originally seen by the global financial sector as a compliance headache. However, the Basel accords are not just about compliance. Adopting Basel as the minimum standard for assessing the risks banks face and to ensure sufficient capital, increases overall operating efficiency. Banks are realizing there have been real business benefits through implementing Basel, as well as potential capital savings. Improving the bank's reputation, rating systems and more effective pricing are just some of the realized benefits.

Addressing risk issues in banking is not simply a cost of doing business; it is a path to greater understanding of your business and to achieving efficiency and profitability. Combining SBV oversight, advisory insight, and proactive willingness within the sector to adapt; a stronger, more robust and more sustainable banking system can be developed in Vietnam.



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