LEGAL UPDATE
April 2024

MAJOR CHANGES IN THE NEW LAW ON CREDIT INSTITUTIONS

KEY TAKEAWAYS

- On 18 January 2024 Vietnam passed the new law on credit institutions which will substantially replace the existing law on 1 July 2024.
- The new law primarily addresses urgent issues of Vietnamese banks of manipulative practices by a shareholder or a small group of shareholders. To mitigate this risk, new preventive measures such as reduced shareholder ownership limits, stricter credit limits, and addition of new supervising bodies have been introduced.
- The new law also expands business models of banks like "bancassurance," "security agency" and "assignment of payment agent" services. Additionally, the law grants foreign banks greater autonomy in determining the organizational structure of their Vietnamese branches.
- Following the issuance of the new law, the State Bank of Vietnam is tasked with issuing a series of circulars to detail the implementation of the new law.

OVERVIEW

On 18 January 2024, the Vietnam's National Assembly passed Law No. 32/2024/QH15 on Credit Institutions ("**New LCI**") which will replace most provisions of the currently effective Law on Credit Institutions of 2010 (amended in 2017) ("**Current LCI**") on 1 July 2024. The remaining few provisions, regarding the conditions for transfer of real estate projects mortgaged with credit institutions, take effect from 1 January 2025.

In general, the New LCI Law focuses on providing new or more detailed regulations to address current issues in Vietnamese banks, such as the concentration of power by a single shareholder or group of shareholders, which can lead to mismanagement, bad debts, and risks to the entire banking system. Other changes generally allow for more flexibility in bank operations. Following the New LCI, the State Bank of Vietnam ("**SBV**") will be required to issue a series of circulars to guide implementation of the new regulations. We will first discuss the key changes of the New LCI that impact bank operations.

NEW PROVISIONS ON OPERATIONS OF CREDIT INSTITUTIONS

Abolition of the Registration With the Department of Planning and Investment

Under previous banking laws, after receiving a License for Establishment and Operation from the SBV, a credit institution (also applicable to foreign banks' branches)[1] had to register its business

[1] A credit institution is defined in the New LCI as "an economic organization with legal personality that carries out one, several or all banking activities according to the provisions of this Law. Credit institutions include banks, non-bank credit institutions, microfinance institutions and people's credit funds." Since a foreign bank's branch does not have legal personality, it is not considered a credit institution under Vietnamese banking law.

activities with the relevant provincial/city Department of Planning and Investment where its headquarter is located. This registration resulted in the issuance of an Enterprise Registration Certificate. Any changes to the license approved by the SBV that affected the information in the certificate also required registration with the same department.

The New LCI eliminates this registration requirement. However, credit institutions are still required to follow a notification procedure which will be guided by the Governor of the SBV (Article 27).

Simplified Approving Procedures for Low-value Loans

Unlike normal loans which requires a credit institution to demand a borrower to submit documents and/or data to prove the borrower's financial conditions, lawful purpose of the borrowing, etc., Article 102.2 of the New LCI only requires a credit institution to "have information" about the borrower's financial conditions and lawful purpose of the borrowing in considering granting a low-value loan. Low value-loans include loans to serve daily needs and credit grants via cards of banks and foreign bank's branches.

The New LCI further provides that the Governor of the SBV will regulate, among other things, the level of value, information about the borrower's related persons and other required information, and the consideration and approval of a loan via electronic means. It is unclear, however, that these regulations will be incorporated into current Circular No. 39/2016/TT-NHNN of the Governor of the SBV dated 30 December 2016 (as amended twice in 2023) or they will be in the form of a new circular.

Autonomy in the Organizational Structure of A Foreign Bank's Branch

The New LCI introduces a major change regarding the organization and governance of foreign bank's branch in Vietnam. Under Article 89.1 of the Current LCI, a foreign bank must "decide on the organizational structure, governance and administration of its branches in Vietnam <u>in accordance with the laws of countries in which it is headquartered</u> and with this Law regarding organizational structure, governance, administration, and internal control and audit, and [such decision] <u>must be approved by the State Bank in advance before implementation</u>" (emphasis added). Article 97.1 of the New LCI simplifies the requirements by providing that: "The organizational and management structure of a foreign bank's branch is decided by the foreign bank and complies with the provisions of this Law on administration, and the provisions of Article 57 and Article 59 of this Law on internal controls and independent audits; Internal audits are carried out according to the foreign bank's regulations." Clearly, the requirements for compliance with the laws of the host country where the foreign bank is situated and a prior approval from the SBV has been removed.

In its explanatory notes, the drafting board of the New LCI explains the reasons for the change as follows:

(a) The needs to change in the organizational structure of a foreign bank's branch may happen anytime. It is impractical for the SBV to review and approve every single request for a simple change as long as the change is in compliance with Vietnamese laws; and

(b) The SBV does not have a similar requirement for other types of banks. The removal is, thus,

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However, it may engage in business activities (and assumes responsibilities) almost similar to a credit institution (subject to the approval of the State Bank of Vietnam) except for establishing or purchasing shares of another company.

to ensure consistency in the SBV's policies.

It is worth noting that regardless of the new rule under Article 97.1, a new appointment of or change in the general director/director of the branch still needs to register with (and approved by) the SBV.

Other Notable Changes in Bank Operations

There are also other changes of the New LCI in bank operations as follows:

(a) Article 113 allows commercial banks (also applicable to foreign banks' branches) to act as "insurance agents" and to assign "payment agents" in accordance with the coming regulations of the Governor of the SBV;

(b) Article 114.2(dd) allows commercial banks (also applicable to foreign banks' branches) to act as an "security agent" for lenders that are international financial institutions, foreign credit institutions, local credit institutions and/or foreign banks' branches in Vietnam; it is worth noting that this new business is subject to the coming regulations and a prior approval from the Governor;

(c) According to Article 101.1, credit institutions (also applicable to foreign banks' branches) must develop and promulgate internal regulations for their professional activities,[2] which encompass activities handled by electronic means. These regulations must be sent to the SBV within ten calendar days from the date of promulgation; and

(d) Article 15.5 prohibits credit institutions (also applicable to foreign banks' branches), their managers, executives, and employees from associating the sale of non-mandatory insurance products with the supply of banking products and services in any form.

FOR RISK MANAGEMENT IN BANKING OPERATION

Reduction in Ownership of Shareholders

The New LCI mandates a decrease in the ownership ratios of a corporate shareholder and a shareholder and their related persons in joint-stock credit institutions. In particular, while Article 63 retains the maximum ownership of an individual in a join-stock credit institution at 5% of the charter capital of a credit institution, it reduces ownership of a corporate shareholder (in both direct and indirect forms)[3] from 15% to 10% of the charter capital. Similarly, ownership of a shareholder and their related persons is decreased from 20% to 15% of the charter capital of the credit institution.

Nevertheless, shareholders and their related persons who own shares in excess of the share ownership ratio specified in Article 63 prior to the effectiveness of the new LCI may continue to

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2 Which are listed out in Article 101.2 to include: (i) credit granting and credit management; (ii) classification of assets, setting up and use of risk provisions; (iii) assessment of asset quality and compliance with the minimum capital adequacy ratio; (iv) liquidity management, including liquidity management procedures and limits; (v) internal controls and internal audits; (vi) internal credit rating system; (vii) risk management; (viii) prevention and combat of money laundering; and (ix) emergency plans.

3 Indirect ownership is defined under the New LCI as "when an organization or individual owns the charter capital of a credit institution through an investment trust or through an enterprise in which they own more than 50% of the charter capital."

maintain their shares but must not increase shares except in the case of receiving dividends in shares.

It is worth noting that the reduction of ownership ratios mentioned above does not apply to, among other things, foreign investors whose ownership ratios are stipulated in specific commitments of Vietnam in international treaties (e.g., WTO, EVFTA agreements, etc.) and are detailed in Decree No. Decree No. 01/2014/ND-CP of the government dated 3 January 2014.

Reduction in Credit Facilities to Customers

To mitigate risks associated with excessive credit facilities to a single customer or a customer and their related persons, Article 136 of the LCI sets new limits for credit facilities[4] granted by a bank or a foreign bank's branch. The new limits are based on the maximum percentage of the equity of a bank (or of a foreign bank's branch in Vietnam) and are detailed in the below table.

No.	Time Period	To A Single Customer	To A Customer and Their Related Persons
1	1 Jul. 2024 – 31 Dec. 2025	14% (from currently 15%)	23% (from currently 25%)
2	1 Jan. 2026 – 31 Dec. 2026	13%	21%
3	1 Jan. 2027 – 31 Dec. 2027	12%	19%
4	1 Jan. 2028 – 31 Dec. 2028	11%	17%
5	1 Jan. 2029 onward	10%	15%

Importantly, the limits consider the value of any bonds purchased from the borrower and their related persons. Banks and foreign banks' branches must reduce their credit exposure to comply with these limits within the specified timelines. If compliance cannot be achieved by the deadline, approval from the Prime Minister is required.

Additional risk mitigation measures include:

(a) Article 49 strengthen information disclosure requirements for executives and managers of a credit institution;

(b) Article 69.1 increases in the minimum number of the member/director of the management board of a joint-stock bank to two. Additionally two-thirds of the board members must be independent members and those who are not executives of the bank;

(c) Articles 156-194 establish a more comprehensive framework for intervention measures in troubled banks. These measures include early intervention, support during bank runs, special controls, mergers and acquisitions (M&A), emergency liquidity assistance (backstop), and special loans; and

[4] Credit facilities under the New LCI include credits in the form of loans, discounting, financial leasing, factoring, bank guarantees, letters of credit (which is newly added by the New LCI), and other credit granting operations.

(d) Article 207 expands the oversight framework by assigning inspection and supervisory authority over credit institutions to the Ministry of Finance and other relevant ministries within their state management powers.

We hope our article has been helpful to you. Please feel free to contact us if you have any further inquiries.

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