

THE COMMONALITIES BETWEEN THE ASIAN FINANCIAL CRISIS OF 1997
AND THE CURRENT BANKING CRISIS OF VIETNAM
AND IMPLICATIONS FOR THE FUTURE

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ABSTRACT

This paper revisits the East Asian financial crisis of 1997 through reexamining how imprudent lending and poor credit risk management devastated the financial systems of many emerging countries in East Asia. The paper also explores the state-controlled banking system of China and Vietnam, the two countries least affected by the events of 97. Incompetency and inefficiency, due to non-competitive environment, in banks' operation of these two countries are also addressed. Vietnam, in particular, has recently experienced a banking crisis in which it has repeated the very same mistake that caused the crisis of 1997 regarding credit risk management. This paper proposes potential solutions, some of which has already been undertaken by the Vietnamese authority, to improve the overall health of the banking system and prevent future occurrence. Unsurprisingly, the government and the State Bank play a critical role.

TABLE OF CONTENTS

INTRODUCTION	1
METHODOLOGY	4
LITERATURE REVIEW	4
Definition	4
The East Asian Financial Crisis of 1997.....	5
Vietnam and the Crisis.....	9
State-Controlled Banking System.....	10
Financial and Banking Developments in Vietnam	12
Vietnam's Latest Banking Crisis	14
CREDIT RISK MANAGEMENT AND POTENTIAL SOLUTIONS	18
CONCLUSION.....	20
REFERENCES	22

INTRODUCTION

The Asian financial crisis was a period of financial meltdown that plagued much of East Asia starting July, 1997, raising fears of a worldwide economic depression spurring from financial contagion. The crisis began in Thailand with the financial collapse of the Thai baht, national currency of Thailand. The collapse was partly driven by the real estate market and the exhausted effort of the government to support its currency. At the same time, Thailand had enough foreign debt that made the country bankrupt even before the collapse of the baht. Most of Southeast Asia as well as Japan soon followed Thailand with devalued currencies, depressed stock markets and a shocking rise in private debt. Foreign debt-to-GDP ratios rose from 100% to 167% in the four large Association of Southeast Asian Nations (ASEAN) economies in 1993–96, and then shot up even higher. In order to stabilize the situation, the International Monetary Fund (IMF) stepped in to initiate a \$40 billion program (Radelet & Sachs, 1998, p. 15). Many research and studies have been conducted to examine the cause of this catastrophic event.

According to Radelet and Sachs (1998), East Asian financial institutions had incurred a significant amount of external liquid liabilities that were not entirely backed by liquid assets, making them vulnerable to panics. Additionally, the East Asian countries shared two similar characteristics which ultimately lead to failure. First, well-connected borrowers could still obtain credit. Second, there was the lack of implicit government guarantees. For example, in South Korea, the government encouraged banks to extend emergency loans to some troubled conglomerates which were having difficulties servicing their debts and supplied special loans to weak banks. These

responses further weakened the financial position of lenders and contributed to the uncertainty that triggered the financial crisis towards the end of 1997 (Moreno, 1998, p. 8). The Asian financial crisis of 1997 definitely left a remarkable lesson for future generations. Although the collapse swept through most of Asia and Vietnam was affected through trading with neighbors, it didn't impacted China and Vietnam as significantly compared to other countries in the region. The two countries were luckily protected by many deficiencies in their financial systems.

Since the crisis, financial market and banking system in Vietnam has changed drastically. However, it seems that Vietnam has not learned its lesson as the current banking crisis of Vietnam shared a resemblance to the events of 1997. In the first decade of the 21st century, Vietnam has seen significant development in the banking sector. Commercial banks represent a big role in this development. Capital of these banks rose rapidly and became an important factor in Vietnamese economic growth. Along with opportunities came the side effects, as expanding operation leads to increasing bad debts in most commercial bank which eventually became a tumor for the Vietnamese economy. When the amount of bad debts increases to a particular point, it will hinder the development as well as the operations of the banks. As Vietnam became an official member of the World Trade Organization (WTO), the amount of bad debts reduced the banks' core competency as well as customer trust.

In 2012, the bad debt rate in Vietnam increased 66% compared to the previous year and became a serious threat to the economy. At the same time, Moody's Investor Services Corporations downgraded the Vietnamese Government's bond rating from B1 to B2 in September, 2012. The reason for this downgrade is "the Vietnamese banking

system needs to have more support from the government to be stable”, according to Global Credit Research in 2012. In addition, Moody’s has expressed concerns about the faithful representation of the health of banking system by the government. The reasons behind the bad debt rate of Vietnam were that financial institutions extend lending for many private companies and state companies’ investments without careful assessments. When those companies cannot make profit, it becomes bad debt. During recent years, the Vietnamese government has undertaken many actions to reform the banking system. However, an effective strategy has not been proposed and credit risk management of banks is still very weak.

For the remainder of the report, the Asian financial crisis of 1997 will be examined by its causes, including, but not limited to credit risk management in different countries. Commonalities will then be drawn between the event of 1997 and the current banking crisis of Vietnam. How are they similar? How are they different? Why hasn’t Vietnam learned the lesson? Furthermore, a discussion of the role of the State Bank of Vietnam will also be included. More importantly, I will also address technical terms such as NPL (non-performing loans) and credit risk for readers who are not familiar with this topic. Finally, solutions to resolve the current problem will be addressed as ways to improve the overall health of the banking system, and prevent future occurrence.

METHODOLOGY

Throughout the research, a deductive, or “top-down” approach, was taken. First, this paper will present the general picture about the Asian financial crisis of 1997 and the current banking system in Vietnam, including but not limited to, non-performing loans and credit risk management. Most of my time will be spent reviewing previous studies and findings on the subject matter. After that, I would take a look at some of the proposed solutions that has been used over the course of history to see whether it could help Vietnam resolve and prevent future occurrence.

LITERATURE REVIEW

Definitions

Before reviewing the Asian financial crisis of 1997 and the latest banking crisis of Vietnam, I want to address some technical terms such as non-performing loans and credit risk. Banks have to deal with many types of risk including market risk, credit risk, liquidity risk, operational risk, legal risk, business risk, strategic risk and reputation risk. The biggest risk for a bank is credit risk because banks are in the business of lending. Credit risk is the uncertainty that debtors cannot pay back their loans and interest for the bank. Bad debt is the leading cause of credit risk default for banks. The bad debt rate is the percentage of bad debt in the total debt of a bank or the whole banking system. Although loans are the largest and most obvious source of credit risk, there are other sources of credit risk both on and off the balance sheet. According to the Federal Reserve, off-balance sheet items include letters of credit unfunded loan commitments, and lines of credit. Other products, activities, and services that expose a bank to credit

risk are credit derivatives, foreign exchange, and cash management services. In order to manage credit risk, banks will use several mechanisms.

A non-performing loan (NPL) is either in default or close to being in default. Once a loan is nonperforming, the probability that it will be repaid in full are considered to be substantially lower. The IMF defines a loan as nonperforming when payments of interest and/or principal are past due by 90 days or more, or interest payments equal to 90 days or more have been capitalized, refinanced, or delayed by agreement, or payments are overdue. . There are additional reasons why a loan may be considered nonperforming, such as debtor filing for bankruptcy leading to doubt that the payment will be made in full. At what point the loan is classified as non-performing by the bank, and when it becomes bad debt, depends on local regulations. Banks normally set aside money to cover potential losses on loans (loan loss provisions) and write off bad debt in their profit and loss account. In some countries, banks that have accumulated too many NPLs are able to sell them on - at a discount - to specially established asset management companies (AMCs), which attempt to recover at least some of the money owed.

The East Asian Financial Crisis of 1997

The East Asian financial crisis was a remarkable event in which many emerging, rapidly growing economies that were sharply affected. Perhaps more surprising than the crisis itself was the fact that nobody could really foresee the collapse prior to 1997. Many studies and research has been conducted to explain the causes of the crisis and why it was not predicted. Most of those would find that the main drivers behind the crash came from within Asia. It was the corrupted and mismanaged banking system of Asian rapid growing economies as well as the shortcomings of state-managed capitalism. It was also

the lack of transparency in corporate governance which was very prevalent across Asian countries. Many others also argued that the international financial system played a huge role in the onset of the crisis. Radelet and Sachs (1998) were among some of the first scholars that analyzed the crisis with their paper, *The Onset of the East Financial Crisis*. They discussed how the crisis involved many interlinked phenomena, one of which was the rapid reversal of private capital inflows into Asia. During the period prior to the crisis, foreign bank lending went to both domestic banks and non-banks borrowers. They mostly assumed that lending to banks was partly protected by either the central banks of those Asian countries or an international body such as the IMF. The withdrawal of foreign capital depreciated the exchange rates and increased domestic interest rates which led to a tightening of domestic credit before the central banks had time to react. Consequently, the number of nonperforming loans in the banking sectors of Asian countries rose quickly as many real estate projects defaulted. The rise of the nonperforming loans combined with a decrease on the balance sheets due to currency depreciation had led to a substantial decrease in the market value of bank capital in countries like Indonesia, Thailand, and Korea. This further resulted in the cutbacks of banks' lending because the banks themselves were illiquid and decapitalized. The IMF wasn't at much help as its program really added to panic. The IMF threatened to close down undercapitalized banks demonstrated by the suspension or closure of financial companies and banks throughout the regions at the start of its adjustment programs. The IMF also focused its effort on capital adequacy enforcement and tight credit control, which actually heated up the crisis. Indonesia, Korea, and Thailand were three countries under IMF programs where domestic bank lending was halted and companies could

obtain working capital. By the end of 1997, Moody's downgraded the sovereign debts of the three countries, resulting in the debts of these countries being considered junk bonds. There were two critical impact of the downgrade. First, commercial banks were unable to issue internationally recognized letters of credit for domestic exporters and importers. Second, many portfolio managers had to sell off below-investment grade securities, causing debt liquidations. Creditors panic along with the sovereign downgrade forced the three countries into partial defaults. Indeed, as Radelet and Sachs stated, "at the core of the Asian crisis were large-scale foreign capital inflows into financial systems that became vulnerable to panic."

McKinnon and Pill in their 1997 paper, *Overborrowing: A Decomposition of Credit and Currency Risk*, further emphasized the risk of the overexpansion of credit. Although it could be beneficial to economic development, "too rapid an expansion may result in excessive loosening of overall credit conditions." As banks have access to more accurate information than private sector, they could send out misguided signal about optimistic economic conditions through loose credit. Private borrowers were able to borrow at a low interest rate without the bank adding in any risk premiums which led to even more overborrowing. Indeed, in developing Asian countries where credit was not well regulated and default risk was more prevalent in the financial system, capital inflows created opportunities for banks to offer lending to speculative purpose which exposed systematic financial risk and macroeconomic instability. Moreover, in *Asia's Financial Crisis: Lessons and Policy Responses* by Moreno, Pasadilla, and Remolona (1998), imprudent lending by Asian financial systems were also discussed. Many financial intermediaries did not always have access to all business criteria in allocating credit. In

some extreme cases, well-connected borrowers could not be refused credit. Similarly, poorly managed companies could still receive loans just to meet some government objectives. In addition, financial intermediaries were not expected to suffer from the cost of failure. They were protected by implicit or explicit government guarantees against losses that arose from the fact that “government could not bear the costs of sufficiently large shocks to the payments system, or the intermediaries were owned by Ministers’ nephews” (Krugman, 1998a).

Many may think that such a contagious collapse could be predicted by market observers, but as a matter of fact, it was not. As Radelet and Sachs further explained in their paper, although the increasing inflow of foreign funds into Asia was a precondition for the following crisis, these conditions did not explain the crisis by themselves. One of the major indicators of market condition was the risk premiums associated with loans to emerging markets. If the markets anticipated growing risks of capital inflows, lending terms and conditions would have been tightened. However, it was the opposite before the crisis. While international credit-rating agencies supposed to constantly provide assessment of credit risk in emerging markets, their statistics did not signal increased risk. Long-term debts ratings for Asian countries remained unchanged to the first half of 1997; the outlook was actually viewed as “positive” and “stable.” Other companies that analyzed risk as well as investment banks also didn’t anticipate the increase in risk. In addition, macroeconomic indicators such as domestic savings were very positive throughout the region. They suggested that macroeconomics fundamentals were strong and even with the reversal of capital flows, economic growth would still continue. The most indicators of risk came from the financial sector but they were neglected. Both

short-term debts to international banks and domestic claims on private sector increased to very high levels. Many would argue that those signals while showed vulnerability and the need for adjustment could not predict the actual crisis.

Vietnam and the Crisis

Although the collapse swept through Southeast and East Asia, it affected China and Vietnam much less severely compared to other countries in the region. The two countries were luckily protected by their incomplete nature of banking reforms and financial market development (Gottschang, 2001, p. 2). Their currencies were not yet traded internationally while the securities markets were still in the very early stage of development. Tax codes, trade regulations, and accounting treatments were also behind international standards. These shortcomings in their financial system were results of centrally planned economies that they followed under Soviet guidance for 30 years. Loans to firms were distributed on the basis of planned activity, or under government direction in which firms were owned by government. There were no significant privately owned firms or financial instruments that supported the operations of these firms. However, such structure also presented many problems. There was no infrastructure in term of physical, intellectual, and human capital to support a market-based financial system. In addition, state-owned enterprises (SOEs) were operating very inefficiently. There are no competitive pressures for the state banks to improve weaknesses. Bank managers and employees had no incentives to develop professional knowledge and credit analysis capabilities. Furthermore, they executed two functions of commercial lending and government-directed lending at the same time, but the two were not clearly separated. Because of different political forces, banks felt comply to provide lending for

these SOEs. By forcing the banks to hold a significant amount of non-performing debts, the government reduced the banks' ability to extend credit to worthy projects and threatened the foundation of a market-based financial system.

However, Vietnamese banking system still shared some common characteristics with other countries that were hit by the crisis. The ratio of NPLs to total bank loans and the exposure risk are very high, which resulted from bad lending practices, inflexible exchange rate management as well as weak prudential regulation and supervision (Doan, 2000, p. 19). Vietnamese banks also carried high risk on credits based on properties as the legal frameworks for collateral banking was still lacking. Information disclosure on enterprises and institutional building process suffered from similar underdeveloped situations.

State-Controlled Banking System

To further understand the state-controlled banking system of Vietnam, I want to examine a similar system operating under the Chinese government where state-controlled banks make loan decisions based on noisy inside information on prospective borrowers, which could potentially leads to unemployment and social instability. In *Bank Loans with Chinese Characteristics: Some Evidence on Inside Debt in a State-Controlled Banking System*, Bailey, Huang, and Yang discuss responses that follows bank loan announcements, particularly for borrowers measuring poorly on quality and creditworthiness, or for lenders or borrowers involved in litigation regarding loans. As rapid economic and financial growth happened in China under the leadership of Deng Xiaoping, the demand for banking services has increased substantially, but the banking system is troubled. Chinese banking is dominated by state-owned banks, operating in a

non-competitive environment and facing a lot of social and political pressure.

Unsurprisingly, Chinese banks continue to be plagued with a large amount of non-performing loans. The Chinese Banking Regulatory Commission reported \$174 billion of NPLs or 6.17% of total loans at the end of 2007, which could really be an underestimation. Nonperforming loans at China's banks rose by an additional 54 billion yuan in the three months through March, the biggest quarterly increase since 2005, to 646.1 billion yuan, according to CBRC data released May 15 despite the fact that China has spent more than \$650 billion rescuing banks by carving out bad loans and injecting capital since the late 1990s

Starting in the late 70s, loans available for companies were provided mostly by four state-owned specialty banks. Currently, these four banks still hold the majority of the banking sector's assets despite the fact that loaning activities from these banks are decreasing. Reforms has been implemented to improve the profitability of the state banks including transferring bad loans to state-owned asset management corporations and turning state banks into corporations owned by shareholders. In addition, the government has allowed foreign investors to take minority ownership in the state banks, hoping that these global financial services firms could provide additional capital, technology, and management skill. Three out of the four banks were also listed on the Hong Kong Stock Exchange with the intention of improving governance, transparency, and profitability.

Despite many initiatives taken by China, the banking system still suffers from many problems. Operations are still constrained and influenced by government intervention and political causes. Credit risk management is still behind international standards, lacking an effective program to monitor borrowers. Bailey, Huan, and Yang

also pointed out that poorly performing firms are more likely to receive bank loans, and these loans appear intended to keep troubled firms afloat as subsequent long-run performance is typically poor. After loan announcements, stock prices of borrowers decline significantly. The effects are deepened for borrowers with frequent related-party transactions, poor subsequent performance, high state ownership, and no foreign ownership.

Financial and Banking Developments in Vietnam

Like China, Vietnam has also made significant progress through two phases of economic reforms. In *Banking and Financial Sector Reforms in Vietnam* (2009), Leung summarized briefly the many initiatives that has been taken by the Vietnamese governments over the past decade and examined unresolved problems. The deregulation of domestic interest rates from 1996 to 2002 was one of first major steps to reform the financial sector. In May 2005, the government also decided to restructure and equitize state-owned commercial banks (SOCBs) by 2010. Vietnam's banking sector is made of four major SOCBs, 37 joint stock banks (JSBs), 37 foreign bank branches, 6 joint venture banks, and two development and policy banks. Unsurprisingly, the SOCBs still hold over half of the banking sector assets both in terms of loans and deposits although they did not operate efficiently. Returns on assets for three out of the four SOCBs were below the average for Asian banks. Similar to China, the amount of NPLs plagued the SOCBs. Government regulations continue to allow these stated-own banks to discriminate against borrowings from the private sector in favor of stated-own enterprises. Although banks remain the largest players in the financial market, informal finance, with an advantage in

“solving the inherent information asymmetry problems,” still holds an important role in Vietnamese households and businesses.

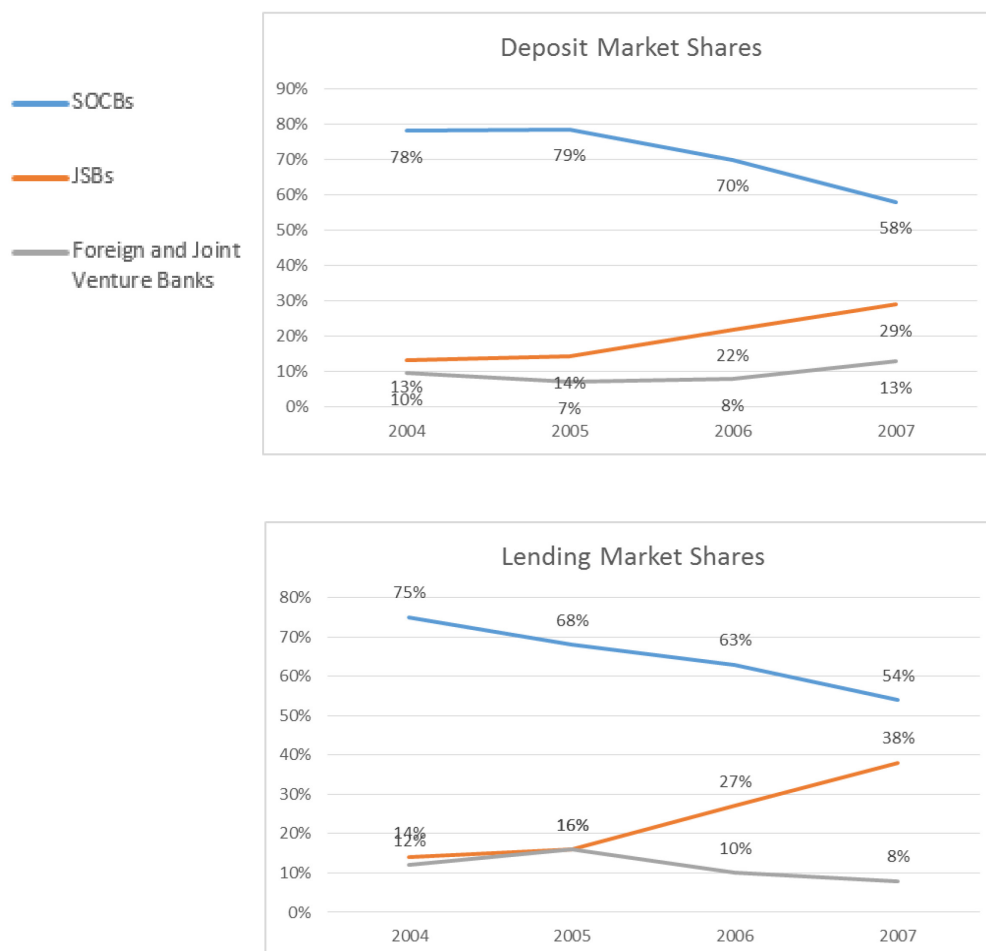


Figure: Vietnam’s Lending and Deposit Market by Bank Types (Gottschang, 2001)

Vietnam has two stock markets operated under supervision of the government. High speculative market activities remained prevalent as the government tried to address asymmetric information problem through more accurate disclosures and better corporate governance. The debt market, though it showed growth, still only accounted for a relatively small part of the GDP. There were several significant weaknesses that hindered the development of a very important source of capital. First, there had been no

coordination between government borrowing requirements and cash management.

Second, private sector borrowings have been poorly managed due to the lack of reliable corporate disclosures, credit-rating agencies, and other market infrastructure. Finally, there also has been no agency that managed government borrowings which comprised of both domestic and international debts.

The process of equitizing and selling large state-owned enterprises was delayed during the period prior to the recession of 2008 with the rationale that with the size of these conglomerates, Vietnam would be able to compete with others in the post-WTO world. Until the outbreak of macroeconomic turbulence in 2008, the operations of these large conglomerates had been condoned under the slogan of a “market economy with socialist orientation.” After the recession, many have argued that these conglomerates played a huge role in overheating the economy. It is becoming increasingly clear that the activities of these corporations added to the amount of non-performing loans of the banking system but also actually contributed to the destabilization of the macroeconomy.

Vietnam’s Latest Banking Crisis

As previously mentioned, bad debts cause significant turmoil in the banking system that requires urgent solutions. Slow collection of debts will sharply impact the operations of banks as it means that banks will experience a decline of cash in their reserves. As a consequence, without cash, banks cannot expand their lending and make any profits which hurt enterprises as they will not be able to get loans to fund their own operations. Ultimately, it leads to a decline in the total outputs of the overall economy. Assets settlement in particular is another challenging issue that Vietnam has to face due to differences between many legal documents. In order to qualify for a loan, debtors have

to use asset as collateral. When that loan becomes bad debts, the bank will try to settle those assets to recover the amount it has lent out. However, settling those assets is a tricky task for banks in Vietnam.

According to the State Bank of Vietnam (SBV)'s Policy No. 03/2001/TTLT-NHNN, banks and financial institutions are not allowed to sell the debtors' deposit assets directly to collect money without debtors' permissions. In Article III of this SBV's Policy, the banks can only send the debtors to court or sell the debtors' deposit assets by auction. In lending contracts, the banks usually have the condition that, if debtors break the payment schedule that mentioned in the contract, the bank has the right to sell the deposit assets for collection purpose. In fact, it is impossible to sell the deposit asset if the bank cannot deal with debtors to get permission. Even after sending the debtors to court, there are still many obstacles that banks have to overcome. With a weak legislation and enforcement system, the collection of bad debts takes a long period of time. Another challenge that banks usually face is the illiquidity of the deposit assets. As a large proportion of bad loans are collateralized by land and property investments, managers of state-owned companies who sell assets for less than their purchase price can be accused of 'destroying state assets', a crime punishable by imprisonment. "Banks find it difficult to foreclose under existing rules and recoveries average only about 15 percent of loan value. The healthier banks are hoping to grow out of their difficulties. But, as long as they are forced to carry these assets, lending growth will be slow and the companies themselves are severely cash strapped", Prof. Jonathan Pincus of Harvard University commented (Drysdale, 2013).

In November 2012, the State Bank of Vietnam announced it was preparing to inject 28 trillion Vietnamese dong (\$1.4bn) into Sacombank. In August of the same year, SBV, for the first time ever, publicly guaranteed depositors their money would be safe following the arrest of Nguyen Duc Kien, co-founder of Vietnam's fourth-most valuable bank, Asia Commercial Joint Stock Bank. In January 2013, one of the four biggest state-owned banks of Vietnam, Agribank, published a report about its bad debt rate. Until the end of December 2012, the bad debt rate of Agribank is above 1 billion EUR, about 5.8% of the total debt. The bad debt rate of three other state-owned banks also stood at a very high level. Specifically, the total bad debt of the four biggest state-owned banks is more than 1.67 billion EUR. The Vietnamese banks' impaired balance sheets have hindered their ability to provide credit in support of economic growth, which has already been affected by slowing external demand: loan growth has been flat through end-August despite aggressive monetary easing by the central bank since March 2012.

However, the problem didn't just stop within the banking sector. In 2009, in an effort to reduce the effect of the global economic downturn on Vietnam, the government made a huge tranche of cheap credit available to its enormous state-owned enterprises, which had been dominating important sectors of the Vietnamese economy. Many of these SOEs used this credit to diversify into industries in which they had little or no experience. PetroVietnam has significant concerns in hotels, securities, real estate, insurance and even taxis. Vietnam Electricity (EVN) has holdings in telecommunications and education, and shipbuilding giant Vinashin in catering, distilling and insurance. Vinashin in particular amassed a mind-blowing 639 billion VND in debts. The company had to plead creditors to extend loan repayments and asked the governments, again, for financial

supports. Other SOEs weren't doing any better. PetroVietnam accumulated 72.3 trillion VND, EVN 62.8 trillion VND, and mining giant Vinacomin 19.6 trillion VND. Of the total owed by the SOEs, 200tr VND was considered bad debt.

On September 28, 2012, Moody's downgraded government bond rating to B2. The lower rating was given based on two basic rationales. First was the higher likelihood that contingent risks to the government's balance sheet will be realized due to more pronounced weaknesses in the banking system. Second was the expectation of lower medium-term growth prospects for the country's economy, stemming from the banking system's declining capability to intermediate credit. The banking system vulnerabilities kept intensifying because of the overhang from a prolonged credit boom and the subsequent tightening in policy. According to Moody's in this report, over the 5-year period between 2007 and 2011, average domestic credit growth of 33.7% far exceeded average annual nominal GDP growth of 21.3% and average annual real GDP growth of 6.6%. Quantitative and qualitative restrictions on loan growth since early last year, while helping to alleviate overheating pressures, have contributed to a deterioration in asset quality in a system already characterized by relatively low levels of capital adequacy and poor transparency. Moody's further emphasized that the costs of recapitalizing the banking system would be very likely to be funded, at least partially, by the government given the lack of private sector solutions. Because of the highly interconnected nature between banks within the system and the need to preserve the confidence of the general public, the government had to provide extraordinary support, although political considerations affected the size and timeliness of such assistance. As the government had to carry the burden related to recapitalization of the banking system, it was constrained in

term of formulating effective fiscal policy in response to a more severe slowdown in global growth. A more stable macroeconomy, a decline in inflation, a healthy balance of payments, and a rise in foreign exchange reserves couldn't adequately offset the vulnerabilities posed by weaknesses in the banking system.

CREDIT RISK MANAGEMENT AND POTENTIAL SOLUTIONS

Credit analysis, which involves the process of determining whether to approve a loan, is the single most important aspect of the banking business as banks make profit by lending. Managing risk effectively is the goal that any bank aims to achieve. In practice, relationship officers usually make some preliminary judgments based on customer's behavior as well as documents. With their experience, relationship officers try to find out any unusual signs worth noticing from borrowers. Banks will then begin the lending procedure and loan assessment in order to decide if they should approve or reject a loan application. Beside the list of the important tasks and questions that the banks use in credit analysis, the banks also create other tools for this important process such as internal credit rating systems. Internal credit rating system is another critical tool that banks used to analyze the data of customer and facilities. These systems analyze the adequacy of the loan-loss reserves or capital, the profitability and the loan-pricing analysis. Credit risks can be identified fully and measured properly. When applying for a loan, borrowers need to provide their information such as financial situations and credit history. This system will make calculations based on those inputs with credit rates as the outputs.

In order to control the bad debt rate and credit risk, every bank has its own credit policies. Normally, those policies will include risk identification, risk measurement, risk grading techniques, risk control techniques and other document about legal issues (Bangladesh Bank Report 2005). In the same report, Bangladesh Bank pointed out that good credit policies need to have the following criteria:

- Provide detail credit evaluation
- Provide risk identification, measurement, monitoring and control
- Define the target market, risk acceptance criteria, credit approval authority and guideline to portfolio management. (Bangladesh Bank Report, 2005)

Although the countries have encountered many bank runs, Vietnam has yet been thrown into a major financial crisis. However, it would need deeper structural reforms in order to avoid what happened with many South East Asian countries in 1997. When the Asian financial crisis hit in 1997, Indonesia also had non-performing loans of around 8 percent of total banking assets. Once bank runs began and the government was forced to guarantee deposits in order to stabilize the banking system, non-performing loans increased rapidly and quickly plagued the banking sector. When large enterprises owned the banks they borrow from, they were happy to default on their loans once they knew that taxpayers risk losing their capital in paying back depositors. The State Bank of Vietnam has to work with other ministries in unwinding the bank ownership positions of large economic groups, which will ensure that these groups don't involve in non-core businesses such as banking. In addition, according to Decision 254, the state-owned commercial banks will still be the dominant players in a restructured Vietnamese banking sector. "These banks must not be given undue incentives to lend to state-owned

enterprises, and those state-owned companies to whom credit lines are given should be sound and profitable enterprises. For these reasons, state-owned enterprise reforms and bank restructuring in Vietnam will only be effective if they occur simultaneously,” Leung commented.

The SBV also believed that settling bad debts through the Vietnam Asset Management Company (VAMC), set up in July 2013, was the optimal solution. VAMC was established to help commercial banks settle their bad debts. It has reportedly cleared VND123 trillion worth of bad debts from commercial banks’ books. However, only VND4 trillion of that 123 trillion was settled, which means that the remaining debts were still in VAMC’s coffers. Many economists doubted that VAMC would only make the debt situation worse. Dr. Nguyen Tri Hieu, a renowned banker, stated that the only thing VAMC could do was to write off debts from banks’ balance sheets, while it couldn’t settle the problem to its root cause. Although the bad debts had been taken away from bank balance sheets, they were put on VAMC’s balance sheet. One of the problems Hieu also mentioned was that VAMC did not have real money to buy bad debts as they used bonds for debt purchase. VAMC’s chartered capital was only VND500 billion which too small compared with the bad debt value, estimated at hundreds of trillions of dong (Tuoi Tre News, 2013).

CONCLUSION

Imprudent lending and poor credit risk management are the two major causes of the East Asian financial crisis of 1997. More than a decade later, Vietnam, with a state-controlled banking system, was thrown into a major banking crisis by the very same reasons. Both crisis sharply damaged the financial system and significantly hindered

economic growth because of actions and behaviors that can be managed and avoided. No matter what measures are taken, the problems won't be resolved without addressing credit risk appropriately. It further reiterates the importance of well-constructed credit risk policies for not only each bank's individual business but also the whole banking system and the overall economy. Although effective credit risk management has been discussed globally over the years, it is always easier said than done when it comes to implementation on a national scale. The government of Vietnam, especially the State Bank, plays a critical role in providing the guidelines, the procedures, and the enforcement of prudent lending. In addition, the state needs to create a competitive environment for banks to improve themselves – an environment free of political pressure and agenda. Foremost, building healthy balance sheets for banks requires collective efforts from different participants of the financial system. Regulators, commercial banks, borrowers, credit rating agencies, and large enterprises all have to participate in the game with a collaborative mindset where transparency and accuracy of information were placed at the highest regard.

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