International workshop on "Banking system restructuring – International experience and policy implications for Vietnam"

BANKING SYSTEM RESTRUCTURING
INTERNATIONAL EXPERIENCE AND POLICY IMPLICATIONS FOR VIETNAM

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Hanoi, December 21, 2011

I. SOME ISSUES OF BANKING SYSTEM RESTRUCTURING: INTERNATIONAL EXPERIENCE

II. LESSONS OF SUCCESSFUL RESTRUCTURING AND SOME POLICY IMPLICATIONS FOR VIETNAM

I. SOME ISSUES OF BANKING SYSTEM RESTRUCTURING: INTERNATIONAL EXPERIENCE

1.1. Reasons for restructuring

1.2. Subjects of restructuring

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1.4. Difficulties and risks in restructuring

I. SOME ISSUES IN BANKING SYSTEM RESTRUCTURING: INTERNATIONAL EXPERIENCE

1.1. Reasons for restructuring:

The banking system is in crisis resulting in threat of social and economic crisis, or a big bank goes bankrupt with a danger of spread to the whole system.

1997-1998: Thailand, Malaysia, Indonesia, South Korea…

1.2. Subjects of restructuring

- *In broad sense:* Restructuring the whole banking system: i) Central Bank; ii) Commercial banks; iii) Financial companies…

- *In narrow sense:* Restructuring above-mentioned separate parts or individual but systematically important banks

1.3. Methods of restructuring: Diversified

(i) Strengthening or building the legal framework (Law on Bankruptcy, Law on merger and acquisition, provisions on dispute resolution…) and regulating mechanisms and policy (deposit insurance, making provision, requirements on minimum capital, accounting standards in accordance with international practices), supervising and evaluating based on international standards.

(ii) Establishing specialized agency to undertake restructuring process.

(iii) Dealing with Non-Performing Loans (NPLs).

1.3. Methods of restructuring: Diversified (continued)

(iv) Recapitalizing (the Government injects capital or buys shares to take over management, merging domestic banks with foreign banks or with other domestic banks; changing ownership forms …)

(v) Treating corporate loans (through assets management companies…).

(vi) Renewing corporate governance, technology and human resources…

Authorities to conduct banking restructuring:

	NPL Management	Bank Recapitalization	Mediation of Debt Workout
Indonesia	IBRA (Indonesian Bank Restructuring Authority)	IBRA	Jakarta Initiative Task Force
South Korea	KAMCO (Korea Asset Management Corporation)	**Korea Deposit Insurance Corporation**	Corporate Restructuring Coordination Committee
Malaysia	Danaharta	Danamodal	CDRC (Corporate Debt Restructuring Committee)
Thailand	TMAC	Financial Institutions Development Fund	CDRAC (Corporate Debt Restructuring Advisory Committee)

Some forms of restructuring applied for problem financial institutions

	Closures	State takeovers	Mergers
Indonesia	64 Banks (18%)	12 commercial Banks (20%)	4 of 7 state banks to be merged into a single bank (54%)
South Korea	5 commercial banks, 17 merchant banks, and more than 100 non-bank financial institutions (15%)	4 commercial banks (25%)	9 banks and 2 merchant banks to create 4 new commercial banks (15%)
Malaysia	None	1 commercial bank, 1 merchant bank, and 3 financial companies under central bank control (12%)	6 mergers of finance companies and commercial banks (2%)
Thailand	57 financial companies (11%) and 1 commercial bank (2%)	7 commercial banks (13-15%) and 12 financial companies (2.2%)	5 commercial banks and 13 finance companies into 3 banks (20%)

Note: Figures in parentheses refer to percentage of assets in the financial sector

(Source) World Bank [1999], Global Economic Prospects and the Developing Countries, 2000, Table 3.5

Dealing with NPLs

	Indonesia	South Korea	Malaysia	Thailand
Centralized asset management corporation buys assets at subsidized prices	Yes	Assets were initially purchased above market-clearing prices with recourse. Since February 1998 purchases have been attempted at market prices	Purchased assets are valued by independent outside auditors	Not applicable
Type of assets transferred	Worst assets	No particular strategy	Loans larger than 5 million ringgit, and mostly loans secured by property or shares	Not applicable

(Source) World Bank [2000], East Asia: Recovery and Beyond, Table 4.5 (extracts)

Changes in corporate governance and management of banks

Changes in Corporate Governance and Management of Banks				
Country	Corporate governance		Management	
	Independent outside directors	Changes in top management In majority-owned domestic banks	Performance-based pay	Hiring of foreign experts in domestic banks
Indonesia	Rare	State bank management changed	Rare	Limited
South Korea	Two-thirds of board seats	Occupied by outside directors In 6 of the 11 major banks	Being introduced	Frequent
Malaysia	In place	In 1 of 33 banks	Limited	Rare
Thailand	In place	In place In 3 of 11 banks	Limited	Frequent

Source: S. Claessens, et. al., Financial Restructuring in East Asia: Halfway There?, Financial Sector Discussion Paper No. 3, The World Bank, September 1999

1.4. Difficulties and risks in restructuring

Firstly, **risk of long-lasting restructuring** for there is lack of legal framework, scientific basis (data base…) and institutional capacity for restructuring the banking system (eg. schemes of resolving assets).

Secondly, **risk of dependence on foreign banks:** the number of banks in short of liquidity and with bad assets is quite large in the banking system; the number of good banks which is capable of acquiring others is much less than the number of bad banks. The national financial and monetary security.

1.4. Difficulties and risks in restructuring

Thirdly, **Risk of public confidence erosion.** State-owned banks may have implicit guarantee for depositors. Meanwhile, that the Government declares not to insure private banks may lead to bank runs, or closures of some banks can lead to doubts of soundness of other banks in the system.

Fourthly, **Risk of interest conflicts** arising in the restructuring process. They are conflicts of interests of depositors, different groups of shareholders, banks, borrowers…

1.4. Difficulties and risks in restructuring

Fifthly, **Risk of costs arising** in the restructuring process and tolerance of the economy. International experiences have shown that costs of the restructuring can occupy from 20 up to 50% of GDP if the restructuring occurs after crisis (20% of GDP in Korea; over 30% in Thailand and over 50% in Indonesia)

(*Paul M. Dickie, Strenghening East Asian Financial Systems. Asian Studies Institute Working Paper 10*)

II. LESSONS OF SUCCESSFUL RESTRUCTURING AND SOME POLICY IMPLICATIONS FOR VIETNAM

2.1. Lessons of successful restructuring

2.2. Some policy implications for Vietnam

II. LESSONS OF SUCCESSFUL RESTRUCTURING AND SOME POLICY IMPLICATIONS FOR VIETNAM

2.1. Lessons of successful restructuring

Firstly, it is necessary to have **high political determination** as well as public consensus and sponsorship.

Secondly, countries which succeeded in restructuring correctly evaluated the situation, nature and seriousness of shortcomings in their banking system, they identified root causes and work out the overall restructuring plans.

2.1. Lessons of successful restructuring (continued)

Thirdly, a significant factor resulting in successful restructuring process is **"speed" or timeliness and quickness**. The plan of strengthening the banking system is an important part in restructuring.

Successful countries carried out this action plan within one year once shortcomings of the banking system had exposed.

Hawkins & Turner (1999) compared different reactions of Japan and Scandinavian countries to the last 02 serious crises and concluded that firm and timely actions of Scandinavian countries helped their banks recover more quickly than Japanese banks.

2.1. Lessons of successful restructuring (continued)

Fourthly, countries should **combine many ways of restructuring in a general but flexible way**. Besides, the agency in charge of restructuring and the restructured institutions play very important roles.

In Thailand, the Advisory Committee on Financial Restructuring was established to provide necessary guidance.

In Indonesia, the Committee responsible for restructuring banks is compounded with representatives from relevant state agencies.

2.2. Some policy implications for Vietnam

i) What are the reasons for Vietnam's banking system restructuring?

- Vulnerability of Vietnam's banking system (increasing risk of bad debts; poor quality of governance, technology and human resource; liquidity risk, institutional risk, credit risk…).

- Not really effective performance (of the banking system and its impact on the whole economy)

- Requirement of global integrity (internationalization, international standards, competitiveness, reactions to external shocks…).

- Requirements of new stage of Vietnam's socio-economic development (high-quality, effective, socio-economic and environmental sustainable development).

2.2. Some policy implications for Vietnam (continued)

ii) How should we define the "Vietnam's banking system restructuring"?

- A process of resources re-allocation: a) Finance; b) Operations (Human resource, organization, mechanism, technology, governance,…); c) Legal framework (legal basis, regulation, supervision, monitoring, evaluation,…); d) Structure (ownership, assets…)… to ensure healthy and effective performance of banks which should exert good impact on the macro economy, inducing better access of people and enterprises (especially SMEs) to banking services.

- A component of the financial system restructuring and the economy restructuring.

2.2. Some policy implications for Vietnam (continued)

iii) Principles for Vietnam's banking system restructuring

- Public confidence in the banking system

- Reasonable speed of retructuring with least cost

- Respect of market principle

2.2. Some policy implications for Vietnam (continued)

Encouragement mechanism based on market principle:

The punishment and rewarding mechanism should help market members be aware that they will have the most benefits if they conduct prudent business activities as regulated by law (in capital allocation, risk management…)

- Concise and direct rules and regulations (on minimum capital, asset quality…)

- Guidelines on restriction of asset growth in risky activities (real estates, securities…)

- Independent and capable central bank (transparency in requirements, enhancement of supervising competence …)

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THANK YOU !