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MKM227 Postgraduate Dissertation

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BASEL III AND THE RISK MANAGEMENT OF BANKS IN VIETNAM

A dissertation submitted in partial fulfilment of the requirements of the Royal Docks Business School, University of East London for the degree of MSc Finance and Risk

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Word Count: 15,237

I declare that no material contained in the thesis has been used in any other submission for an academic award

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BASEL III AND THE RISK MANAGEMENT OF BANKS IN VIETNAM

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ABSTRACT

Commercial banking system of Vietnam is the lifeblood of the economy and considered to be one of very sensitive areas. Hence it is always faced with the problems of risk in business activity as credit risk, liquidity risk, interest rate risk, etc. The last time, the complex evolution of the economy such as high inflation accompanied by speculation was the premise for risk gradually revealed. In this situation, it required banks to quickly identify, detect risks to the banking business to timely process. In summary, to commercial banking system of Vietnam become highly competitive, dynamic, and implement operational goals safely and effectively in business, research and apply solutions to prevent and limit risks in the business activities of commercial banks of Vietnam is sorely needed, namely, the application of the standards of the Basel accord on banking management. However, the application of stringent standards of Basel is not a simple task for a country with developing economy such as Vietnam. By analyzing the performance of banks in Vietnam in recent, it is possible to evaluate the real capacity of the banks and find appropriate solutions for the improvement of Vietnam's banking system.

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CHAPTER 1: INTRODUCTION

1.1 RESEARCH MOTIVATION

Basel Capital Accord, with content of standardization on management of credit risk, market risk, operation risk, is considered as major turning point in reform process of global risk management. Thanks to these revolutionary contents, Basel becomes global standards in risk management instead of just implementing in multinational banks of member countries in Basel Association known as G20 as initial aim. According to survey of Basel Committee on banking supervision, there are over 120 countries all over the world applying Basel as a standard for banking administration.

In fact, as countries' banking systems, aim of banking system in Vietnam is safe, efficient and sustainable. Moreover, in comparison with international practice, risk level in operation of Vietnam's commercial banks is quite high and unforeseen. Therefore, analysis and application of Basel standards are essential to ensure safe not only in Vietnam's commercial banks but also for the whole economy in the context of internationally economic integration.

With tough standard, Basel Accords caused real challenges, even for modern bank in over the world. Therefore, it is not surprising when applying Basel encountered significant barriers in the banking system of developing countries including Vietnam. In Vietnam, the State Bank of Vietnam (SBV) and the credit institutions have adopted the treaty to the macro-management and risk management policies. However, there are still many problems for applying Basel Agreements, so initially only some simple criteria have been selected to use instead of accessing all terms at the same time.

In the future, the State Bank of Vietnam should improve the legal system as well as system of Vietnamese banks, especially banks with international operations. They will have to comply with the Basel standards to improve a system of banking risk management in order to meet international integration requirements sooner or later. Therefore, the question of "How to improve risk administration in Vietnam's banking system through application of Basel Agreements" is a considerable issue.

And, to solve this problem, the thesis will first present an overview of main content of Basel Agreements as a basis to evaluate risk management of Vietnam's banks. Next, the thesis will analyses real situation of Vietnam's banking system through analysing risks and risk management, supervision of banks and management bodies. Thereby, assessments of the extent of compliance with Basel's standards of Vietnam's bank will be given. And, this thesis will explore causes and limitations which makes difficulty in applying Basel in system of risk management in Vietnam's banks. And finally, this thesis will have to find ways to solve and overcome such difficulties.

1.2 INTRODUCTION OF BASEL ACCORDS

1.2.1 Basel I

After series of bank collapses in the 80s, a group of central banks and supervisory authorities of ten developing countries (G10) gathered in Basel city, Switzerland in 1974 seeking to prevent this trend. After the meeting, these agencies decided to form the Basel Committee on Banking Supervision (BCBS), providing general principles for management of the activities of international banks.

In 1988, the Basel Committee on Banking Supervision (BCBS) has approved a document named the Basel Capital Accord (Basel I) in which it requires banks with internationally active to hold a minimum capital to be able to deal with risks that may occur. The minimum capital requirement is a certain percentage of the total capital of banks, so it is also known as 'Capital Adequacy Ratio' (CAR) for banks.

The purposes of Basel I

- Strengthen stability of the entire international banking system.
- Establish a unified and equal banking system to reduce unhealthy competition among international banks.

Initially, Basel I was only applied for international banking activities of the group of 10 developing countries. Later, Basel I had become the global standard and applied in more than 120 countries. Under the provisions of Basel I, banks should determine the minimum capital ratio (Capital adequacy Ratio - CAR) of at least 8% to compensate for possible risks. This prevention measure is required to ensure that banks have the ability to overcome losses without affecting the interests of depositors.

$$CAR = \frac{\text{Tier 1 Capital} + \text{Tier 2 Capital}}{\text{Risk Weighted Assets}}$$

In which:

- Tier 1 capital (core capital) included common stock, long-term incentive stock, capital surplus, retained earnings, general provision for other capital reserves, transformable entrustment means and credit loss reserve. It is a charter capital and reserve funds which were announced.

- Tier 2 capital (Supplementary capital) includes all other capital as profits on invested assets, long-term debt with maturity more than 5 years and hidden reserves (such as subsidies for loans and leases). However, unsecured short term loans do not included in this definition of capital.

- Under the provisions of the Basel Committee, the limits in calculating the Bank's total capital as follows: the total of Tier 2 capital should not exceed 100% of the total of Tier 1 capital, subordinated debt must not exceed 50% of Tier 1 capital, a general provision is up to 1.25% of risk assets, revaluation reserves are discounted by 55%, maturities of subordinated debt at least 5 years, bank capital does not include intangible assets.

- Risk Weighted Assets (RWA): Basel I only mentions credit risks, and different properties will have different risk weights

RWA Basel I = Asset * Risk Weight

According to Basel I, the risk weights of the risky assets are divided into 4 levels of 0%, 20%, 50% and 100% according to risk level of each asset.

Table 1 Classification of assets under risk weight (Basel I)

Risk Weight	Classification of Assets
0%	Gold and cash in banks Debt obligations of the Government and Ministry of Finance
20%	Accounts payable of large banks Securities issued by state agencies
50%	Housing mortgage loans and etc.
100%	All other loans such as corporate bonds, debts from developing countries, stock mortgage loans, real estate and etc.

As changes in market, in 1996, Basel I was amended taking into account market risks, including general market risk which are changes in market value due to large fluctuations in the market and specific market risk which are changes in value of a certain property. There are 4 types of economic incidents that give rise to market risk as interest rates, foreign exchange rates, securities and commodities. And market risk is measured by two methods: the standardised approach and the internal model approach - these internal models can be used only if the bank meets qualitative and quantitative criteria set out in Basel.

In 1997, the Basel Committee has set out twenty- five core principles for effective banking supervision to ensure the safety in banking operations of credit institutions, especially with the large banking groups with international operation scope. Although there are many innovations but Basel I is still quite limited, particularly one of these limitations is to not mention to operational risks which are becoming increasingly complex.

1.2.2 Basel II

In order to overcome the limitations of Basel I, the Basel Capital Accord II was issued by the Basel Committee with effective date being on December, 2006 (hereinafter referred to as Basel II). Basel II made clear that risk management needs to be considered in terms of the overall risks of the bank's operations, with specific guidance on deployment mode and methods. Basel II consists of a series of monitoring standards to improve risk management techniques and is structured as three pillars:

- First Pillar: The banks need to maintain a large enough amount of capital to cover their risk activities, including credit risk, market risk (interest rate risk and currency rate risk) and operational risk. Hence, calculating capital ratios has a lot of changes, particularly, for credit risk is major modification, and minor change to market risk. Moreover, it is noteworthy that for the first time, the operational risk is mentioned in the calculation of the ratio of capital.

- Second pillar: Banks need to accurately evaluate the types of risk which they are facing and to ensure that supervisors will be able to assess the adequacy of these evaluation measures. In this pillar, Basel II emphasizes four principles of review of surveillance:

    - Banks should have an assessment process to evaluate a full extent of their capital by risk category and must have a appropriate strategy to sustain such capital.

    - Supervisors should review and re-evaluate the assessment process of internal capital level and the bank's strategy. They must be able to monitor and ensure observance of the minimum capital ratio. Accordingly, supervisors should perform some appropriate supervision actions if they are not satisfied with the outcome of this process.

- Supervisor recommends that banks should maintain capital levels above the minimum prescribed.

- Supervisors should intervene at an early stage to ensure that the bank's capital levels are not reduced below the minimum prescribed and may require modifications immediately if otherwise.

- Third pillar: Banks need to publicize information in an appropriate manner based on market principles. In this pillar, Basel II gives a catalogue of requirements to oblige banks to disclose information such as information about capital structure, full extent of capital to information related to the sensitivity of bank for credit risk, market risk, operational risk and the evaluation process for each type of risks.

Application scope of Basel II is wider in comparison with Basel I, including not only international banks but also parent companies. Basel II changes the definition of assets adjusted for risk, and there are more methods to choose from in risk assessment. Basel II is a series of rules to regulate the multi-national banking operations. Basel II maintains a capital adequacy ratio at least 8% but changes calculating method. Specifically, the total capital is unchanged, however, many changes in the calculation of risk-weighted assets are that the credit risk and operational risk newly introduced in the Basel 2 are measured based on a variety of methods. And in this way all risks are clearly reflected in the formula:

$$CAR = \frac{\text{Capital (tier 1\& tier 2)}}{\text{Amended credit risk + market risk+ operational risk}}$$

Measurement coefficient of Basel II is more complex; many methods to choose from, but with the ability to accurately assess the level of adequacy capital, and allow very large discretion in supervising banking activities.

Basel II classifies the level of risk on a basis of ranking, so banks will have to mainly depend on assessing and ranking results of credibility of the independent organizations such as Moody's, S&P, Fitch, etc.

The measurement methods of the Basel II

- Credit risk measures
  - Standardized approach: depending on the assessment of the independent credit rating agency
  - Foundation IRB approach: banks offer accounts with default risk
  - Advanced IRB approach: banks offer a wide range of input information about risks.
- Market Risk measures
  - Standardized approach: issued by the banking authorities to create an uniformity on modes of organization and measurement implement in the entire banking system.
  - Internal models approach: banks develop internal models measure on their own in accordance with characteristics and scales of banking activities (to be used only when approved by the central bank).
- Operational risk measures
  - Basic indicator approach: A criteria for a regulation.
  - Standardized approach: Multiple criteria for a regulation.
  - Advanced measurement approaches (AMA): Banks apply internal mode.

PILLAR 1 Risk Assets Ratio	PILLAR 2 Supervisors	PILLAR 3 Market Discipline
Measurement of risk assets ratio changed to include: (1) New measurement of credit risk; (2) Measurement of market risk (unchanged since 1966); (3) Measurement of operational risk.	Role of supervisors in their review of banks: to encourage banks to develop *internal* methods to assess capital, setting capital targets consistent with the bank's risk profile and its internal control methods	Use of market discipline: banks to disclose their method for computing capital adequacy, how they assess risk, credit risk mitigation techniques

Source: Heffernan (2005, p.194)

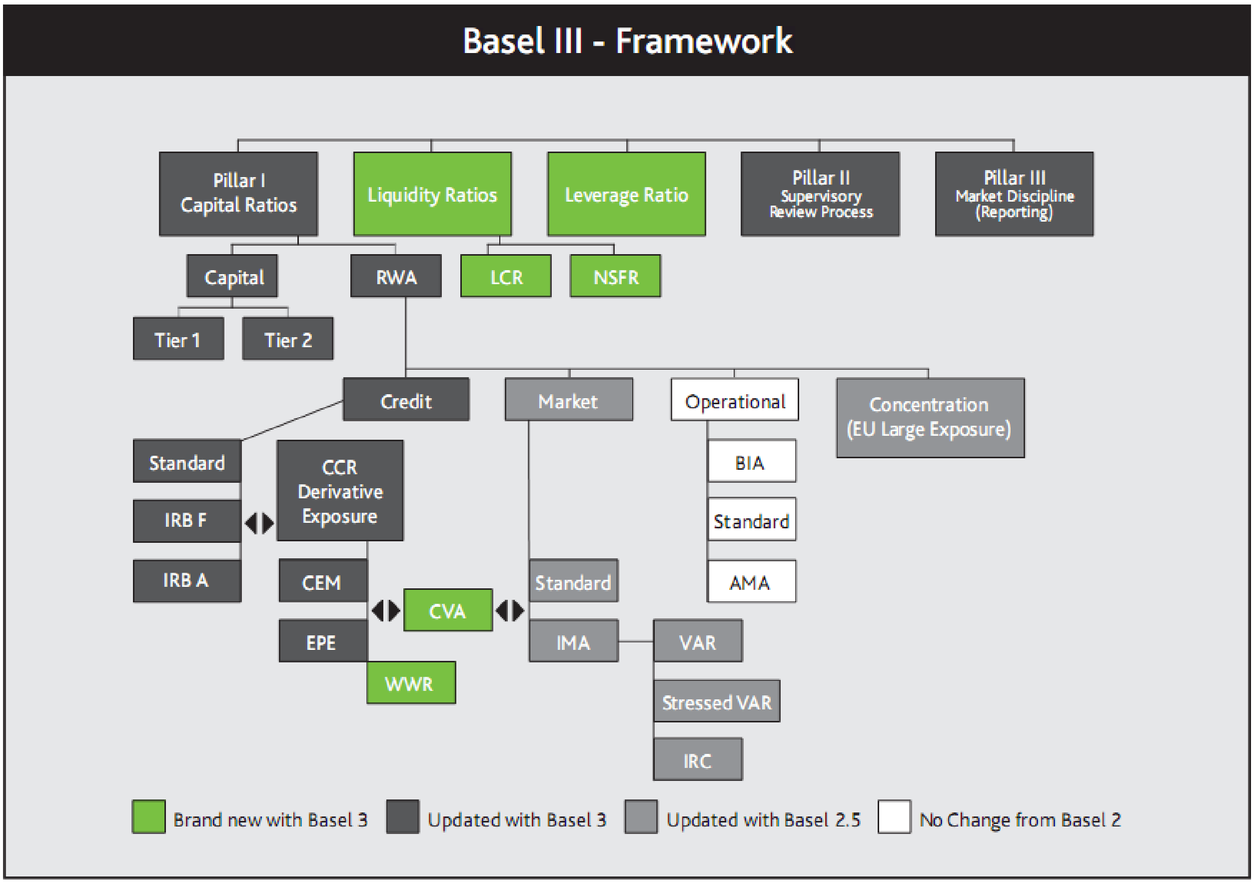
In 2006, a revised version of core principles for effective banking supervision was published by BCBS. These basic principles are divided into a number of groups having the following main contents:

- Group of principle 1: terms of effective banking supervision
- Group of principles from 2 to 5: licensing and structure
- Group of principles from 6 to 18: Prudential regulation and requirements
- Group of principles from 19 to 21: Methods of ongoing banking supervision
- Group of principle 22: Accounting and disclosure
- Group of principle 23: Corrective and remedial powers of supervisors
- Group of principles from 24 to 25: Consolidated and cross-border banking supervision

1.2.3 Basel III

In order to deal with shortcomings of Basel II's regulations and try to prevent a recurrence of the global financial crisis, the Basel Committee on Banking Supervision has developed Basel Capital Accord II into Basel Capital Accord III with more stringent rules for twenty-seven member banks. Thus, the goal of BCBS's reform package is to improve an ability of the banking sector to absorb shocks arising from economic and financial stress, regardless of source, thus reducing crisis risk spilled from financial sector to the economy.

Basel III has a lot of new proposals on capital, standards of leverage and liquidity to reinforce the regulation, risk management and supervision of the banking sector. Standards of capital and new capital buffers will require banks to hold more capital with higher quality than those under Basel II regulations. With new liquidity and leverage ratios, Basel III introduces a risk-free measure to supplement requirements on minimum capital based on risk and measures to ensure banks sufficient funds to maintain in case of crisis. Specifically, Basel III has also required all loans with higher risk levels to achieve the highest risk coefficient of 150% (i.e., risk assets will be multiplied by 1.5).



Source: Moody's Analytics (2012)

Summary of changes:

Firstly, quality, consistency, and transparency of the basis capital source will be raised. In particular, Tier 1 capital mainly includes common equity and retained earnings. The coefficient of the capital adequacy ratio has been maintained at a minimum of 8% but Tier 1 capital is required to reach level of 6% over 8%. Notably, such 6% should consist of 4.5% of common shareholders. Deadline to implement this regulation will be on January 1st, 2015, with a more obvious and detailed roadmap. Roadmap to implement Basel III started from January 2013 and will be complete in late 2018. In addition, instruments of Tier 2 capital will be balanced harmoniously and Tier 3 capital will be removed.

Secondly, the level of capital to ensure incurred risks will be enhanced: Strengthening capital requirements for the credits to incurred customers, for transactions to secure loans, derivatives and other financial transactions. At the same time, Basel III also require to raise reserved capital for risks, cycle reduction and providing additional incentives to transfer the derivative contracts on the open market to foreign exchange transactions at banks (clearing payment centre) and provide incentives to strengthen risk management of reciprocal credit.

Thirdly, Basel Committee provided a leverage ratio as a supplementary measure for risk framework established in Basel II. Therefore, the Committee is required to present a leverage ratio to achieve the goals which first and foremost, develop a second layer for leverage in the banking industry and besides, propose additional safeguards against model risk and measurement error by supplementing an anti-risk measure which is a simple measure based on the overall risk.

Fourthly, the Committee is proposing a series of measures to promote developing capital buffers in good times that can be drawn when stress period ("Reducing cycle and promoting the counter-cyclical buffer ").

Finally, the Committee is developing an international standard of minimum liquidity for international banking operations, including a requirement to ensure the liquidity ratio of 30 days is underpinned by a rate of long-term liquidity structure called as ratio of stabilization reserve. The Committee is also considering demand of additional capital, liquidity or other supervisory measures to reduce the externalities created by major institutions established systematically.

Basel Committee on Banking Supervision

BANK FOR INTERNATIONAL SETTLEMENTS

Basel III phase-in arrangements

(All dates are as of 1 January)

	Phases	2013	2014	2015	2016	2017	2018	2019
Capital	Leverage Ratio		Parallel run 1 Jan 2013 – 1 Jan 2017 Disclosure starts 1 Jan 2015				Migration to Pillar 1	
	Minimum Common Equity Capital Ratio	3.5%	4.0%	4.5%				4.5%
	Capital Conservation Buffer				0.625%	1.25%	1.875%	2.5%
	Minimum common equity plus capital conservation buffer	3.5%	4.0%	4.5%	5.125%	5.75%	6.375%	7.0%
	Phase-in of deductions from CET1*		20%	40%	60%	80%	100%	100%
	Minimum Tier 1 Capital	4.5%	5.5%	6.0%				6.0%
	Minimum Total Capital	8.0%						8.0%
	Minimum Total Capital plus conservation buffer		8.0%		8.625%	9.25%	9.875%	10.5%
	Capital instruments that no longer qualify as non-core Tier 1 capital or Tier 2 capital	Phased out over 10 year horizon beginning 2013						
Liquidity	Liquidity coverage ratio – minimum requirement			60%	70%	80%	90%	100%
	Net stable funding ratio						Introduce minimum standard	

*Including amounts exceeding the limit for deferred tax assets (DTAs), mortgage servicing rights (MSRs) and financials.

- - transition periods

Source: Bank for International Settlements (2013)

CHAPTER 2: REVIEW OF LITERATURE

2.1 Obstacles in implementing Basel III all over the world

Basel III's future seems to be not certain as agreement reached since global banking system is in trouble of capital source and liquidity. Moreover, Basel III's standards are non-binding but only as a basis for drafting each own set of rules in consistency with general principles. This will lead to differences among countries in conducting Basel III's regulations.

2.1.1 Time constraint

According to Chabanel (2012), different areas and states have to confront different problems and challenges in adopting Basel III. In 2012, while European countries and other nations such as Hong Kong, Japan and Singapore was in their way to prepare for Basel III, others had their own roadmaps, for example, the United State of America, under its Dodd-Frank Act, a great deal of banks will be applying Basel III from 2005 forward. This context results in more complexity in conducting Basel III for banks.

In 2010, the G20 countries agreed to start applying Basel III from January 1st, 2013 and fully deploy in 2019. However, in 2012, U.S Department of Finance affirmed that, banks of America were still not ready to meet requirements on strictly increasing capital (Handley, 2012). Basel III forces banks with international operations to increase the compulsory reserve rate to 7.0 percent, which is much higher than the current standard at 2.0 percent and even higher than the rate of 4.0 percent that applied to U.S. banks after testing banks' endurance in 2009. Even adding more 700 trillion USD in the total asset held in the end of 2010, until now, U.S. financial institutions said that their financial system still lacks 800 trillion USD to meet Basel III's requirements. Moreover, many banks in the United State also concern about adopting Basel III when it is not enough time to gain a better understanding of rules as well as make necessary changes for system.

Nevertheless, U.S. Treasury Department stressed that U.S. regulators still respect international commitment of time for deploying Basel III and effort to accelerate the application process. On the other hand, the U.S. Treasury Department did not give specific time when it expected new rules of Basel Agreement could be applied. American banks have argued to postpone new Basel standards' implement that require higher- quality capital held by banks. The new regulations require enhanced risk coverage, in particular for complex illiquid transactions. US banks also expressed that they hope to use US rules to satisfy Basel III standards.

Moreover, after delaying to apply for new Basel Agreement's rules from the USA, European banks also have required the European Commission to delay the introduction of new regulations for a year until 2014 (Vagnoni, 2012) by a formal letter. First of all, this request arose from lack of capital; therefore, it is necessary to have more time to implement measures to ensure capital under Basel III requirement. In fact, the European Central Bank also wants to loosen regulation on timing since it estimates that large and medium banks in Europe have 1.3 trillion USD shortfalls under Basel III standards in 2011. Besides, the second reason is to recognition of a competitive disadvantage in case of launching Basel III prior to the USA.

European authorities indicated that if provisions of new capital adequacy ratio known as Basel III apply to balance sheet of banks in January 6th, 2011, instead of an extended itinerary within the next six years, it will be up to 56.0 percent of the largest European banks to not be able to meet the rate of 7.0 percent of Tier 1 as required. However, in fact, it can be seen many changes for years. Facing with resistance test of more severe crisis as well as shift of bond market, many banks in the group of 27 countries have actively reduced demand by cutting unessential investments, to restrict lending and switch to a safer assets in consistent with Basel III provisions.

Furthermore, one of the fundamental challenges for emerging countries is also a deadline (Taylor, 2010). There was information that raising more capital as requirements of Basel III could choke off nascent economic recovery. This resulted in increasing fear for banking industry as well as economies. As a consequence, compromise was achieved in which, emerging countries was allowed to extend the deadline for conducting Basel III until the end of this decade.

However, such countries need to have their own roadmap. They have recovered from global recession in 2009 and some are having booms of monetary policy. Raising capital and liquidity criteria, under the name of international requirements, would be beneficial counter-cyclical impacts. This is transition time for Basel III; therefore, it is not good choice for any markets to become the first mover, especially emerging markets. Bankers in emerging markets will debate that they should not be disadvantaged in comparison with rival bankers in developed economies.

In general, the United States and the European Union did not comply with the prescribed time limit for implementation of the new regulations in the Basel Agreement, in which the United States needed more advice, and the European Union was not ready. According to Michel Barnier and Daniel Tarullo, who are the EU financial services chief and Federal Reserve Governor, respectively, both mutually agreed that Basel III should be conducted as soon as possible. The Basel provisions are primary regulatory reaction of the world to financial crisis from 2007 to 2009 to prevent a repetition crisis where banks to get relief by their government. While the EU intended to officially conduct Basel in January next year, the U.S. has reached or exceeded the new capital requirements without having to wait until 2019 despite lateness of Europe's largest banks. Tarullo said that he expected the regulations to be finished in the spring. (Jones, 2013)

2.1.2 Tough rules

The provisions of the Basel III in capital and liquidity properly designed to the context of the U.S. and Europe thereby emerging markets are not easy to implement it. This global reform is disproportionately difficult to the situation of developing countries. It will even affect development of such economies.

However, U.S and Europe could not avoid problems and concerns in implementing new rules of Basel Accord.

Basel III enables banks using the advanced methods for calculating charter capital, so the banks in Europe and Japan, which are eligible to use advanced methods have no problem facing U.S. banks. A question for U.S. banks is that Dodd-Frank Act requires establishing a floor of the "generally applicable risk-based capital requirements" (Hoshi, 2012). To prevent resurrecting the troubles known from Basel I provisions, U.S. regulators should seek surroundings to impose the standard approach to reach advanced banks, while still ensuring respect the spirit of Dodd-Frank Act.

Besides supplying the right environment to support the revival of economic growth, CRD IV package can also simultaneously strike the right balance of protection system for banking investors and consumers in Europe (Fargeot, 2013). It is hoped that the CRD IV package gives a calmer time for bank investors although profits will also be certainly more subdued. At present, the greatest worry is the reality that banks can still apply their own internals model without considering external models to define their minimum prescribed regulatory capital. Certainly, the shortage of external or independent credit rating will likely generate even more troubles with even more perverse priority for risk.

Developing countries will have difficulty in implementation of Basel on increasing banking reserved capital and will be restricted in economic growth (Master, 2012). In a report released on June 10th, 2013 by a group of business known as the B20, bankers and entrepreneurs from emerging economies were warned that provisions in Basel III on capital and liquidity were designed for developed countries such as the United State and European. It is not suitable for emerging economies. That is why such countries will face with many difficulties in conducting this Basel Agreement.

It seems to be globally applied Basel III standards when the Basel committee allowed larger emerging countries in 2008 to joint. However, through the meeting of the group of 20 developing economies in Seoul on Basel III, it can be seen clearly that the demands of the members, who are developing economies, have not been considered (Taylor, 2010). In 2004, the Basel II proved this when conditions designed for Basel II were very difficult to apply when even large corporations also lack credit rating and data to build the system of credit scoring is almost non-existent.

Eventually, introducing of Basel III did not improve the situation but also made it worse. For instance, agreements were created for advanced markets. Moreover, requirement for tier 1 capital is quite high while elements of capital in bank of emerging market mainly include equity and reserves. Besides, bans on financial instruments also cause a lot of difficulty for emerging markets.

Executive Director of Standard Chartered cum Co-Chairman of group B20, Peter Sands said that provisions on liquidity, counterparty risk and commercial finance would reduce supply and increase credit cost of emerging economies. Such reforms are what the U.S.A and European and other developed countries have to do instead of developing nations. Since some of them will cause unintended and really dangerous consequences for some countries where have less developing financial system. (Master, 2012)

For instance, Basel III has regulation on “Liquidity Coverage Ratio” known as LCR, in which to ask banks to hold assets. However, these assets will be easily sold case of crisis erupted. The group B20 affirmed that it would strongly influence to developing countries.

Besides, the LCR provision encouraged banks to hold high-quality government and corporate bonds. Nevertheless, such bonds are quite rare in the countries with nascent capital markets and never present at nations with Islamic financial regulations.

Similarly, co-chairman of the B20 cum chairman of Grupo Financiero Banorte, Guilermo Ortiz argued that Basel II offered unfair penalty on counterparty risk for banks in emerging markets (Master, 2012).

Western banks are able to hedge their own risk by purchasing credit default swaps from partners. Nevertheless, CDS transactions are not available for enterprises and banks in emerging markets.

According to research of BBVA, Spanish banks has found out that increasing 20 percent of capital stock and liquidity reserve led to reducing of 3.0 percent of gross domestic products while decreasing 2.0 percent for the global economy (Master, 2012).

The group B20 also stoked concern that European banks would pour about 2 trillion Euros into assets to meet Basel III regulations. That means properties will be pulled out of emerging markets, reducing competition and increasing credit cost.

And at present, the Basel Committee on Banking Supervision is considering to change regulation of LCR, including alternative choice for government bonds.

2.2 Obstacles in conducting Basel III in Vietnam

With an effort to prevent recurrent of the global financial crisis, in September 12nd, 2010, Basel III applied more stringent provisions for banks in the group of twenty-seven members issued by Basel Committee on Banking Supervision. In which, minimum CAR was unchanged at 8% but Basel

III required to increase equity called as Tier 1 from 4% to 6%. In such 6% of Tier 1, there must be 4.5% of capital of common shareholders. Of which, date for implementing this provision is on January 1st, 2015.

By such provision, some people argued that Vietnam's commercial banks could completely apply following Basel III. According to regulations of Circular No. 13/2010/TT-NHNN, since October 1st, 2010, credit institutions had to ensure CAR of 9%, which is higher than 8% of the previous regulation. Besides, commercial banks only have to increase this ratio in the coming years from 2018 onwards to reach a minimum ratio of 10.5% including financial provisioning buffer.

However, at seminar of RiskVietnam 2011 hold by AsiaRisk in April 26th, 2011, Chhagla Suleman, Risk Director of Techcombank assured that, some Vietnamese banks has not been ready for Basel II at that time but not mentioned for Basel III (Techcombank, 2011). According to Suleman, in order to achieve Basel III, it required to pose new mechanism such as investing in technology, infrastructure with high quality, developing database prior to begin thinking about advanced modal to minimize banks' capital. Suleman identified that "Accepting Basel framework for the whole banking system in Vietnam until 2015 is slightly difficult".

At the same point of view, Hendra Tan, Director of Risk Management of financial service in Ernst & Young indicates that, intend of implementing Basel III of Vietnam in 2015 is quite rush if basing on other countries' experience in managing credit risk (TVSI, 2011). Basel III is the optimal solution, but if Vietnamese bank do not have basis element of infrastructure, it will be inaccessible.

As an evidence for these difficulties, a lot of experts in banking finance show that even major commercial banks in Vietnam, such as Vietcombank, Vietinbank, BIDV, ensure CAR of 8% according to Decision No. 457 and other additional decisions at present but it is calculated under

Vietnam's accounting standard. Therefore, there is a huge difference if CAR is calculated according to international accounting standards. Besides, Tier 2 Capital of banks in Vietnam is still limited and long-term borrowed capital considered, as equity is restricted. On the other hand, the revaluation of fixed assets of the Vietnam's banks for calculating the annual equity is yet to be done. (TVSI, 2011)

Though, John V Nguyen, Deputy Director of risk, compliance and operation of VinaCapital commented that forcing banks to apply Basel III will be challenges, but could potentially been implemented. To do so, commercial banks need to have clear strategy, and specifically evaluate current situation, define issues to immediately deploy. "It will take time about four or five years but it will be good for Vietnam's economy in case of being successful. Especially, in the eyes of foreign investors, Vietnam's market of banking and finance market will be more secure" John said.

However, Philippe Carrel, Vice-President in operating and risk management of Thomson Reuters stated completely different opinion. According to him, it should not be considered Basel II, Basel III as symbol of secured quality (Risk.net, 2008). Basel I was created in the 90s of last century to cope with impact of stock market's collapse. Then, Basel II was the next but financial crisis in 2008 was also happened and now is Basel III. Therefore, a question was raised that what the next problem is? Managers need to observe and monitor to know what good custom for application in the domestic market is. According to Phillip, it is important to know that Vietnam will go further, rather than question of whether Vietnam implement Basel III or not in 2015 and another important thing is that it is the best bank rather than the best compliance bank.

To sum up, Vietnam situation are in trouble for implementing Basel III on both aspects of time constraint and tough rules. Beyond similar difficulties as other emerging countries, it also has its own problems due to specific economy. Such difficulties will be displayed and analyzed in the next parts.

CHAPTER 3: RESEARCH METHODOLOGY

In research, the method is an extremely important factor. Identify the proper method is the path to success as well as a basis and standards for evaluating a project. Theoretical research, research methods, the methodology and research techniques are approaches that are indispensable in scientific research, as well as basis to ensure research results with the scientific quality. Thus, in addition to the objectives defined at the beginning, research methods also play an important role leading to the success of this thesis. This thesis will conduct research to find out solutions for applying Basel Accord to improve the risk management in Vietnam banking system. With that goal, this thesis will be conducted through the qualitative research method that requires the implementation of some techniques such as data collection, data analysis, description, comparison, reasoning, etc.

3.1 Quantitative research approach

Quantitative research and Qualitative research are two approaches often mentioned in projects. In scientific research, quantitative and qualitative research approaches have a huge role to research since thanks to these approaches, researchers can collect data precisely and quickly. However, there are differences between the two methods, namely for qualitative approach, the data collected mainly by words and approach that seeks to describe and analyze the characteristics of the group from the perspective of anthropology. Meanwhile, quantitative research is mainly to collect numeric data and solve relations in theory and test hypotheses. (Saunders, Lewis & Thornhill, 2009)

Both the above research methods actually have the same level of effect on the success of the research papers. However, when both of them can be utilized in the same project, the consequences can be multiplied. The appearance of two qualitative and quantitative methods in one research project will be called mixed research method. As regard to Saunders, Lewis &

Thornhill (2009, 153), mixed approach method is really advantageous in presenting different objectives of a study, minimizing the method effect, generating various outcomes and finally making the conclusions more valid and reliable.

With quantitative research method, thesis will collect quantitative data which are the data belongs to the economic and financial such as interest rates, GDP, the figures relating to loans, deposits, capital, etc. Simultaneously, these are secondary data.

3.2 Secondary data

Secondary data is the kind of data that researcher use more others' products rather than their products. Type of information is collected for using of many researchers then such researchers are considered as the secondary user of data. (Finn, White & Walton 2000, 41). As regard to Saunders, Lewis and Thornhill (2009), this kind of data can be classified into documents i.e. books, articles, reports, voice and video recordings, etc.; multiple sources and survey-based data or combination of some types. Meanwhile, according to Ghauri & Gronhaug (2010), the secondary data is categorized by internal and external sources. It can be seen that such data has an important role in any research as well as it is the first step to develop primary data. The researchers can save time, money as well as effort in case of obtaining available data. (Finn, White & Walton 2000, 41)

Due to the secondary data's importance, its system will be applied selectively and wisely to analyze and appraise matters objectively. Sources of secondary data will be collected mainly from industry reports and the annual reports of the State Bank, the commercial banks; and synthesized and handled under to the requirements of each category. In addition, data from reputable journals such as Financial Times, Journal of Finance, Journal of Banking and money Markets magazine, the Vietnam Economic Times and the website of the state agencies, government, World Bank, international organisations, etc. also is used as a secondary data source for the project.

3.3 Sampling method

According to the State Bank of Vietnam, by December 31, 2012 the system of commercial bank of Vietnam consists of 5 State-own commercial banks, 34 Joint-stock commercial banks, and 50 branches of foreign commercial banks, 5 wholly foreign-owned banks, 4 Joint-venture banks and 47 representative offices of foreign credit institutions in Vietnam with wide dynamic range. Since objective and subjective conditions, this paper cannot have detailed report of the whole system of banks. Instead, the topic is only able to rely on information provided from number of banks; therefore, it should be implemented by the method of sample selection. Sample selected is a group of approximately 10 commercial banks including representative of State-own commercial banks, large joint-stock commercial banks, and small and medium joint-stock commercial banks as tables following:

Table 2 Vietnam State-owned Credit Institutions (2012)

No	Name of Banks	Abbreviated name	Stock code	Charter capital (Billion VND)
1	Joint Stock Commercial Bank for Foreign Trade of Vietnam	Vietcombank	VCB	23,174
2	Vietnam Bank for Industry and Trade	VietinBank	CTG	26,281
3	Bank for Investment and Development of Vietnam	BIDV	BIDV	23,012
4	Vietnam Bank for Agriculture and Rural Development	Agribank	AGR	29,154
5	Housing Bank of Mekong Delta	MHB	MHB	3,055

Source: State Bank of Vietnam

Table 3 Joint-Stock Commercial Banks (2012)

No	Name of Banks	Abbreviated name	Stock code	Charter capital (Billion VND)
1	Saigon-Hanoi Commercial Joint-stock Bank	SHB	SHB	8,865
2	Saigon Thuong Tin Commercial Joint-Stock Bank	Sacombank	STB	10,740
3	Eastern Asia Commercial Joint Stock Bank	EAB	EAB	5,000
4	Asia Commercial Joint-Stock Bank	ACB	ACB	9,376
5	Viet Nam Technological and Commercial Joint-Stock Bank	Techcombank	TCB	8,788

Source: State Bank of Vietnam

3.4 The method of data analysis

This thesis is going to use the method of comparing the relative and absolute numbers to see the application of the capital accords in Vietnam from 1999 to 2012; use statistical inference methods to evaluate the advantages and disadvantages in the application of the accords in Vietnam in the period 1999-2012; and use the methodology to take enforcement solutions with consistency to help improve the efficiency of the implementation of the Basel accord in Vietnam in the future.

3.5 Limitations of the research

Since the difficulty of approach and collection of information of the whole banking system of Vietnam, the thesis only selects and analysis for a number of typical banks in each group banks including state-owned banks and joint-stock commercial banks; others are not identified as objects of research topics. In addition, the limitations of the data source by the delay in updating data and partly due to data security policies in the financial system and banks in Vietnam, thus, the thesis will encounter the limitations and deficiencies in the analysis and findings of research.

CHAPTER 4: THE IMPLEMENTATION OF BASEL ACCORDS AND SOLUTIONS FOR IMPROVING THE BANKING SYSTEM IN VIETNAM

The approach of the Basel Committee's recommendations requires complex techniques, while Vietnam's banking system is in early development stages. Therefore, in order to establish a roadmap as well as identify conditions and solutions for applying Basel II followed by Basel III, it is necessary to assess and analyse current status of Vietnam's banking system and the application situation of the Basel agreements on banking system as well. This chapter consists of four parts: the first part will provide a quick overview on the status of risks in Vietnam's banking system; the second part will evaluate Basel's the application situation of Vietnam's banking system by managing capital adequacy ratio and monitoring management bodies; the third section will provide evaluations and a presentation of causes and difficulties that commercial banks and management bodies encountered in applying Basel Agreements for risk management of banks; and the final section, based on circumstances and conditions of Vietnam's economy, will offer appropriate solutions to solve problems, improve, enhance management capacity and develop a roadmap for banks' applying Basel so as to improve banking system in Vietnam.

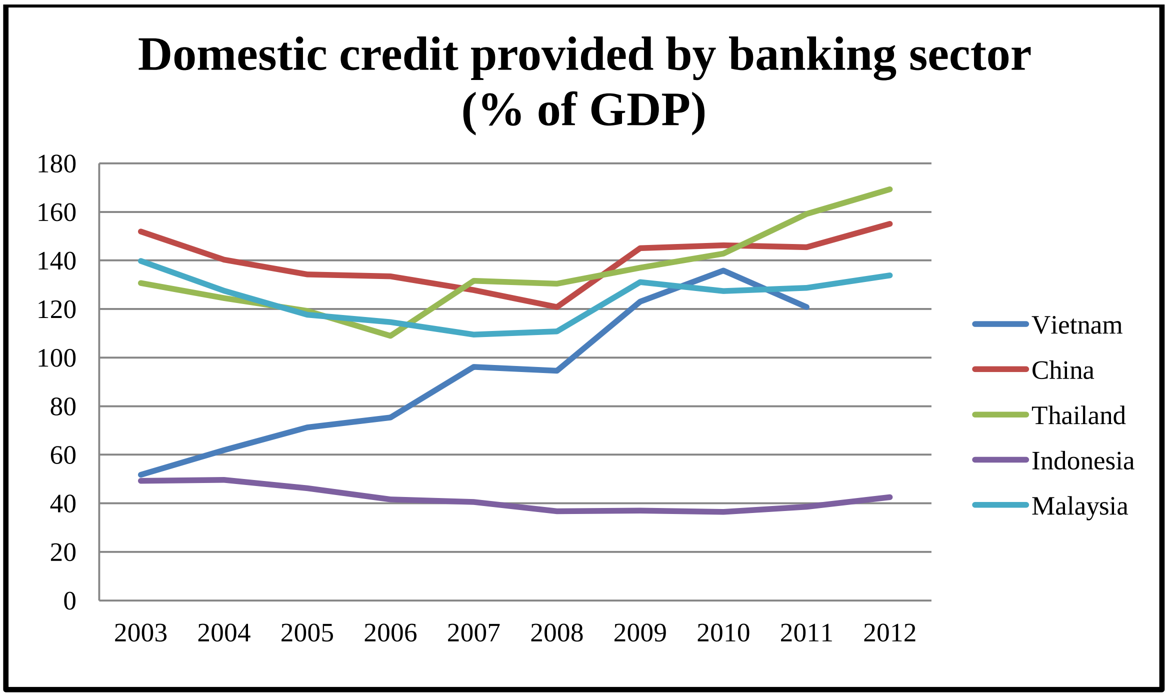
SECTION 1: RISK SITUATION OF VIETNAMESE BANKING SYSTEM

4.1.1 CREDIT RISK

Bad debt situation of Vietnam commercial banks

Credit operations bring main revenue and profit for commercial banks in Vietnam. In 2012, credit operations brought over 80% of total revenue for commercial banks. Therefore, credit risk is always a major concern for banks in Vietnam.

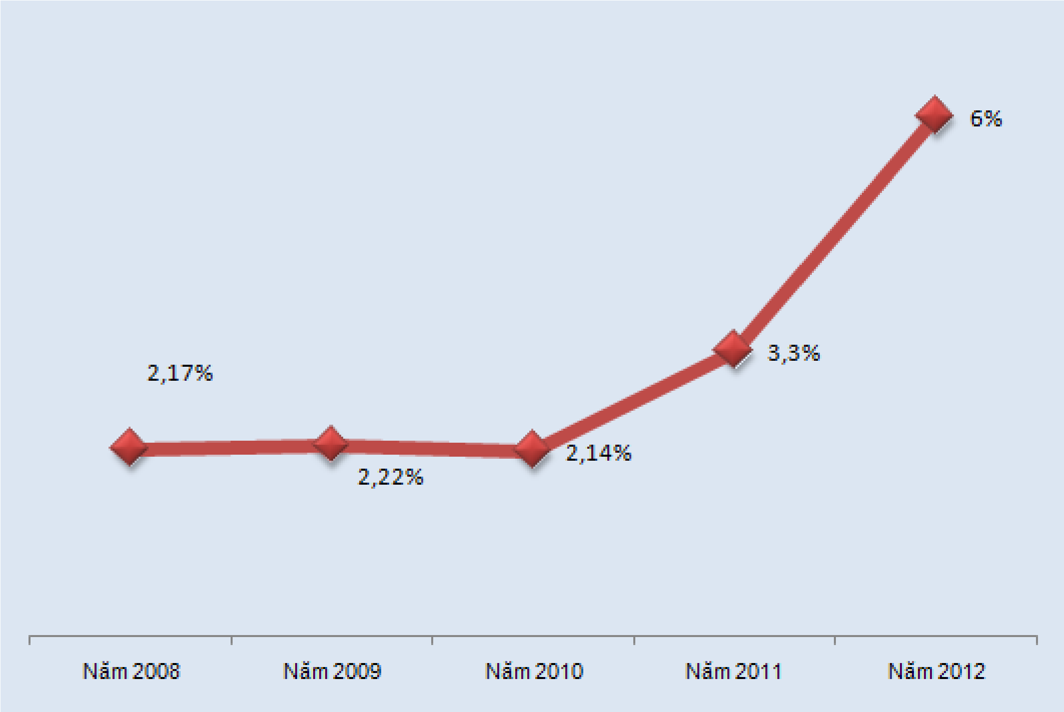
Figure 1 Domestic credit by banking sector (percent of GDP)



Source: World Bank (2013)

According to the data collected from World Bank, it can be recognized that the credit expansion of Vietnam increased sharply in comparison with the growth of GDP since 2007. Comparing to other countries in the region, rate of domestic credit (percent of GDP) of Vietnam had significantly fluctuations during the first decade of the 21stcentury when rising from 51.8% in 2003 to 135.8% in 2010. Clearly, Vietnam's enterprises with weak financial ability were based on capital sources of banks to implement speculative activities rather than investment activities. This led to the whole system of commercial banks to be swept into difficult vortex. Besides, since 2007, rate of bad debt of banks increase continuously. Notably, in 2012, such figure jumped to 6%.

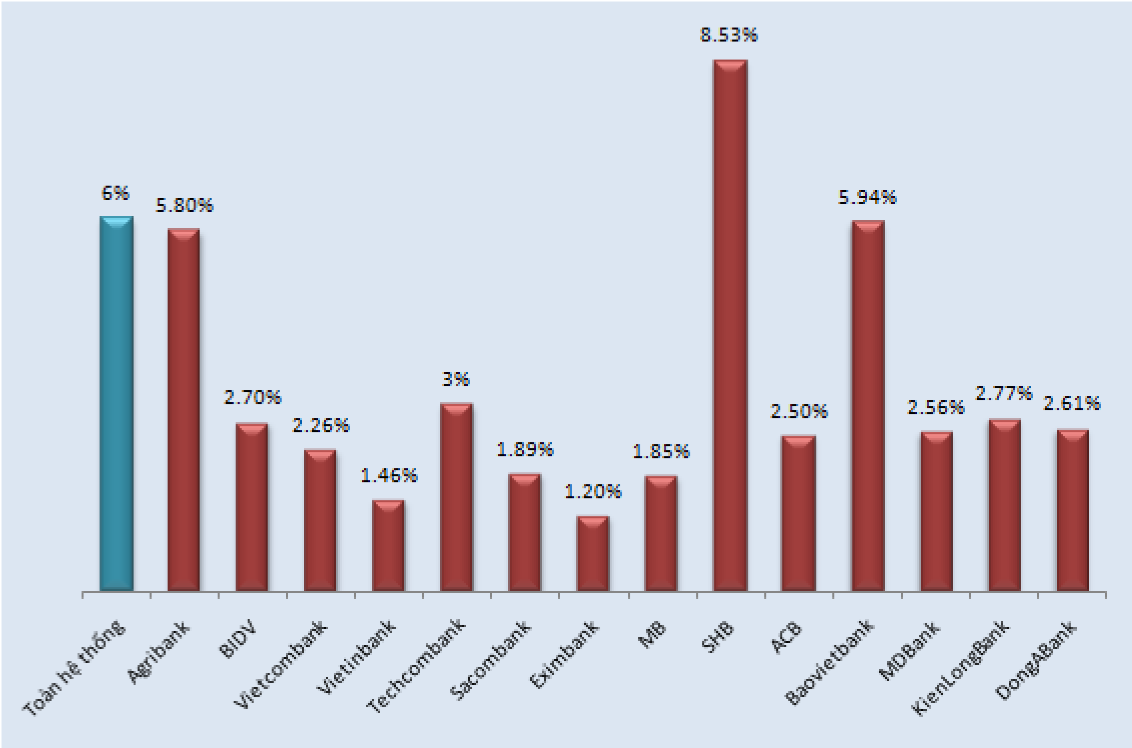
Figure 2 Bank Non-**performing Loans in Vietnam's banking sector**



Source: State Bank of Vietnam (2013)

Looking back at operation results in 2012, it was shown that, the largest commercial bank group mostly maintained rate of bad debts at safety level of less than 3%. However, there are banks with quite high rate of bad debts, typically, Agribank with bad debt rate accounting for 5.8% of total outstanding loan equivalent to 27,803 trillion VND. Agribank's bad debt equaled to total of bad debt of Vietcombank, BIDV, Vietinbank, SHB and ACB combined. In 2012, SHB also had high rate of bad debt up to 8.53% equivalent to 4,844 trillion VND due to suffering more bad debt after merging with Habubank.

Figure 3 Non-performing Loans of some typical Vietnam banks 2012



Source: State Bank of Vietnam

As reported by S&P in 2010, beside instability in the macroeconomic environment, a strong credit growth along with high bad debt ratio has weakened Vietnam's banking system. It leads to situation in which credibility points decline from BB+ to BB for long-term local currency debt and foreign currency credibility points reduce from BB to BB- (Bloomberg News, 2010).

For credit rating in Vietnamese commercial banks, Fitch Rating, U.S prestigious credit rating agency, ranked the fourth largest commercial banks in Vietnam at B level, such as Agribank, Vietinbank, ACB and Sacombank. For the domestic banking system, Fitch has kept D/E and E level when expressed concerns about the transparency and liquidity of the banking system.

Also, according to Fitch (2010), quality of loans remains weak in Vietnam's banks due to Vietnamese Accounting Standards is looser than International

Financial Reporting Standards (IFRS). If loans are assigned strictly according to IFRS, meeting new capital requirements will become more difficult.

4.1.2 LIQUIDITY RISK

Over the past time, in conditions of high inflation, rising prices, the tough competition of interest rate level between banks result in instability of finance and currency market, affecting significantly banking operations. A lot of banks, especially smaller banks with less capital, had fallen into strain on liquidity.

According to Vietnam Banking Sector Report (Quach, 2011), in most banks, the loans to deposits ratio (LDR) rose sharply during the period of 2008 and 2011. And, the LDR of Vietnam banking sector was highest compared with other countries in the region. This trend was continued in despite of liquidity stress in the market in 2011.

Besides, there is severe imbalance of maturity structure between mobilized capital sources and loans. Almost banks raise short-term funds (non-term and less than 1 year), accounting for 70-80% of total capital mobilized, even for some banks, these proportions are higher, while rate of medium-term and long-term loans are not small. In addition, commercial banks appeared to be quite easy for withdrawing money prior to maturity, and then maturity issues of mobilized capital become more sensitive and potentially risky. With major difference between the maturity of assets and liabilities, problem of illiquidity and potential liquidity risk are huge.

Table 4 Capital Mobilisation of Vietnam's Banks

Unit: 1000 billion VND

Year	2008	2009	2010	1st Quarter in 2011	Six months, 2011
Total mobilization of the whole system	1,386	1,784	2,236	2,265	2,288.6
Non-term deposit	548.86	716.92	913.36	924.71	936.03
Weight	*39.6%*	*40.2%*	*40.8%*	*40.8%*	*40.9%*
Short-term deposit (less than 1 year)	612.61	811.8	1,036.5	1,050.8	1,071.1
Weight	*44.2%*	*45.5%*	*46.4%*	*46.4%*	*46.8%*
Medium-term and long-term deposit (more than 1 year)	224.53	255	286.37	289.92	281.49
Weight	*16.2%*	*14.3%*	*12.8%*	*12.8%*	*12.3%*

Source: State Bank of Vietnam, IMF, Fitch ratings (2012)

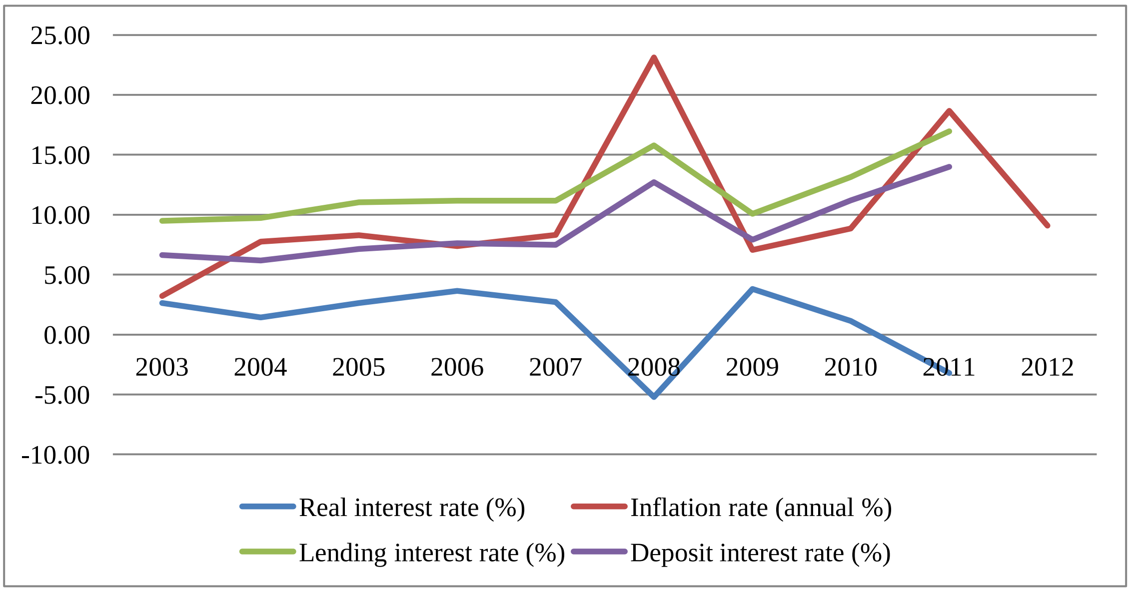
In addition, many mobilization products with 'high creativity' appear in order to address liquidity tensions. In fact, the liquidity management focuses on data records, term structure. However, if it just looks at the data of capital mobilization and loans in the above analysis, it will be difficult to identify that commercial banks are facing with liquidity constraint. The problem is that the bank has taken measures to deal with adopting policy through "inventor" of mobilization products. For example, some banks seek to offer long-term deposit products but allow customers to withdrawal prior to maturity with interest rate equal to initial term interest rate. This mobilization is nominally long-term form but it is short-term form in nature. For this agreement, source of deposits withdrawn before maturity will leave gaps and liquidity risks will arise from these gaps. Moreover, banks offered deposit products with term of one week, two weeks or high-interest deposits with maximum deposit term of two months or deposit products for the purpose of dealing with reserve requirements. With "inventions" above, banks, especially small banks, will temporarily handle liquidity problems, but will continue to face with liquidity problems if finance and currency situation is still in a state of tension.

4.1.3 INTEREST RATE RISK

One of the most remarkable market risks in business activities of Vietnam's banks is interest rate risk. Based on situation of liquidity risk of Vietnamese commercial banks in the recent past, it is clear that abnormal fluctuations in interest rates will adversely affect the liquidity of banks if banks' interest rate risk management is not done well.

Under influence of the global financial crisis in 2007 and 2008, an increase of Vietnam's inflation index results in issuing tighten monetary policy by the state bank, rising required reserve ratio from 10% to 11% per year and increasing base rate from 8.25% to 14% per year in the first six months of year, withdrawing money out of market by issuing compulsory bills at the same time, and forcing treasury to withdraw amount of 50,000 billion VND from commercial banks causing severe shortages of capital for banks. And this led to a wave of interest rate competition among banks in raising capital in the first half of 2008.

Figure 4 Deposit, lending rate and real estate in Vietnamese financial market in the period 2003-2012



Source: World Bank (2013)

After 6 months of racing raising capital, the bank mobilized a huge capital to maintain liquidity of cash flow, ensure high level of safety and low level of risk. Besides, the economic situation showed signs of deflation. Starting from the end of 10/2008, central bank cut interest rates from 14% to 13% and reduced gradually to 7% in early 2009. This rate was maintained until the end of 2009. Therefore, once again, interest rates fluctuated strongly within the year of 2008.

In 2010 and 2011, Vietnam's economy fell into the state of high inflation again, the central bank had to implement tightening monetary policy, commercial banks continued to raise interest rates. Although, in parallel with an increase in deposit interest rates is a rise in lending interest rates, but commercial banks cannot avoid losses due to high rate of inflation during these times (real interest rates were -5.2% and -3.2% in 2008 and 2011 respectively). In February 2012, base rate reached its highest level of 15% in recent years and the figure was recorded at 7% in early 2013.

Thereby, it can be seen that in unstable economic conditions as Vietnam, interest rates are instability and it causes a negative impact to banks' business activities. Therefore, interest rate risk management should be concerned and implemented well by Vietnam's banks.

4.1.4 OPERATIONAL RISK

Operational risk that commercial banks have to face with mainly being risks in the process of the operation, risks due to human beings and information technology system. However, Vietnam's commercial banks have not perceived a severity of operational risk yet, so that there is no bank to have adequate and suitable reserve sources for this type of risk. And in fact, Vietnam's commercial banks were faced with serious problem of operational risk in the past.

In 2004, department of business administration of foreign currency capital in Agribank has business losses, losses wash pushed up to a record number of 499 billion VND in only ten months in late 2004. After investigation, one of the main reasons causing this situation is because of operation process, bank officials did not comply with business processes in the foreign currency trading and accounting. Lax supervision, control and inspection lead to not detect and prevent in time. People relate this event with the bankruptcy of one of Britain's biggest banks such as Baring Bank in 1995. Its bankruptcy came from holes in operating, controlling and monitoring mechanism at a branch in the banking system.

Also in 2004, Vietnam's Foreign Trade bank detected and addressed an officer who was in charge of Treasury Fund of branch's Foreign Trade bank in Ha Noi. During early 2004 to late 2004, this official took advantage of loopholes of professional processes in Treasury Fund and transaction accounting to appropriate the amount of more than 4 million dollars and 200,000 Euros. This officer received customer's money but not stored or put data into banking system. End of date, after checking, fund was still matched with system data, however, it did not reflect an actual amount collected and spent in the day. In the end of financial year, total loss of more than 60 billion VND was discovered when making a balance sheet for general account and comparing intermediate account.

In addition, signs of risk related to IT system appear quite a lot in operating process of commercial banks in Vietnam. At current commercial banks, IT risk mainly consists of:

- ATM is faulty and not able to execute customer's withdrawal order. Vietnam's commercial banks have deployed step by step for modernization of all branches of the system with core banking system and plans to overcome the problems of information technology system but in recent years, banks have faced with signs of potential risks, which can be seen in the table below:

Table 5 Statistics of risk signs related to information technology system of Commercial Banks from 2007 to 2009

	2007	2008		2009	
			+ / - compared to previous year		+ / - compared to previous year
Number of times of computer problems per year	42,382	35,131	-11%	19,215	-43%
Number of times of software errors	11,517	10,451	-4%	4,703	-48%
Deactivated numbers of ATM	3,666	2,120	-25%	1,667	-34%
Inspection of different funds between ATM report and the actual	15,821	10,567	-31%	7,412	-28%
Incident of ATM software occurred	2,089	1,678	-12%	550	-36%
Number of hours of communication interruption at branch	15.125	15.077	-4%	10.309	-25%

Source: State Bank of Vietnam

Overall, during the past, operational risk of Vietnam's commercial banks appeared with increasing frequency. It can be seen that the consequences and losses caused by operational risk are not small, not only affect business results of banks but also greatly influence the credibility and customer's confidence in such banks. Therefore, banks need to effectively take measures and strategy of risk management.

SECTION 2: SITUATION OF BASEL APPLICATION IN VIETNAM

4.2.1 VIETNAMESE LEGAL DOCUMENTS

Vietnam's the State Bank and Credit Institutions have lots of effort in improving legal system of monetary and banking operations as well enhancing governance capacity, especially ability of risk management of Commercial Banks approaching international practices and standards. In which, the State Bank of Vietnam is the body issuing legal documents to update terms of Basel in line with Vietnam's situation. Simultaneously, the State Bank of Vietnam also directly manages and supervises implementation of such legal documents in order to get appropriate adjustment orientations.

Although, the State Bank of Vietnam issued only the first two of Law on State Bank of Vietnam and Law on Credit Institutions in 1997 but after only two years later in 1999, the State Bank quickly updated international standards on ensuring capital adequacy, researched and concretized into two documents. They are namely Decision No. 296/1999/QĐ-NHNN5 issued in August 25th, 1999 regulating on limitation of loans for Credit Institution's customers and Decision No. 297/1999/QD-NHNN5 issued in August 25th, 1999 stipulating prudential ratios in Credit Institutions' operations.

However, even though, the State Bank of Vietnam had attempted much, it was inevitable that these two Decisions have restrictions, since at the time of issuing legal document approaching Basel I by the State Bank of Vietnam, it was also started to propose new frame of Basel Capital Accord called as Basel II by Basel Committee. Therefore, in April 23rd, 2003, the State Bank of Vietnam issued Decision No. 381/2003/QD-NHNN stipulating on amending and supplementing a number of articles and clauses regulated in Decision 297/1999/QD-NHNN5.

Subsequently, in 2005, in order to be more specific on Basel provisions, the State bank of Vietnam promulgated other decisions to replace Decision No. 296/2000/QD-NHNN1 and Decision No.297/199/QD-NHNN5. They consist of Decision No. 457/2005/QD-NHNN issued in April

19th, 2005 on regulation of CAR in credit institutions' operations, identifying the own capital including Tier 1 and Tier 2 from which to define CAR and Decision No.493/2005/QD-NHNN promulgated in April 22nd, 2005 on regulation of classification of debts, provision and utilize of reserves for dealing with credit risks in banking operations of credit institutions. Accordingly, debts of credit institution are divided into five types including group 1 of standard loans, group 2 of noted loans, group 3 of subprime loans, group 4 of suspected loans and group 5 of potentially irrecoverable loans. Corresponding to each group, there are different levels of provisioning namely 0%, 5%, 20%, 50% and 100%, respectively.

Although, the provisions of Decision No. 457/2005/QD-NHNN and Decision No. 493/2005/QD-NHNN have mentioned some problems related to terms of the Basel Accord but remains limited. Thereby, in May 2010, State Bank of Vietnam promulgated Circular No. 13/2010/TT-NHNN in May 20th, 2010 on CAR in credit institutions' operations to replace Decision No. 457/2005/QD-NHNN and related amendments. In addition to new regulation on identifying the own capital, State Bank has guided to determine separated and consolidated capital adequacy ratio, improving a minimum capital adequacy ratio of credit institution up to 9%.

4.2.2 THE IMPLEMENTATION OF BASEL ACCORDS IN CAPITAL ADEQUACY MANAGEMENT

Besides complying with mandatory provisions of the central bank, credit institutions had to give efforts to further improve banks' risk management system to suit specific operating conditions of each bank and approach of the Basel standards step by step. The banks have switched from passive risk management with the following characteristics such as managing after risky business arose; merely reporting results happened; into active risk management with the features named as managing before and during risky business operations arose; monitoring during operation, warning the risk threshold; providing reports and analysis of risk. Accordingly, Commercial banks have had department of specific risk management, beyond management of credit risk, market risk, credit institutions has concerned about operational risk. For example, a number of large commercial banks such as BIDV, VCB, Vietinbank, Agribank, Techcombank, and ACB have established department of operational risk management. And banks also built a system of internal credit ratings. For example, BIDV has been completing a system of internal credit rating according to international practice with three groups of customers such as corporate clients, individual clients and clients which are credit institutions. Based on customers' financial and non-financial information, BIDV has been scoring and ranking customers into 10 categories of the AAA, AA, A, BBB, BB, B, CCC, CC, C and D. For each customer class, BIDV has had its own policy, namely marketing policy, credit extension policy, policy on collateral and etc.

For a specific look, an implementation of the legislation on capital adequacy will be divided into three phases:

(1) The first stage lasted 7 years from 1999 to 2005 which was period for applying Decision 297/1999/QD-NHNN on ratios to ensure safety in commercial banks' activities. In which, capital adequacy ratio was prescribed as 8%.

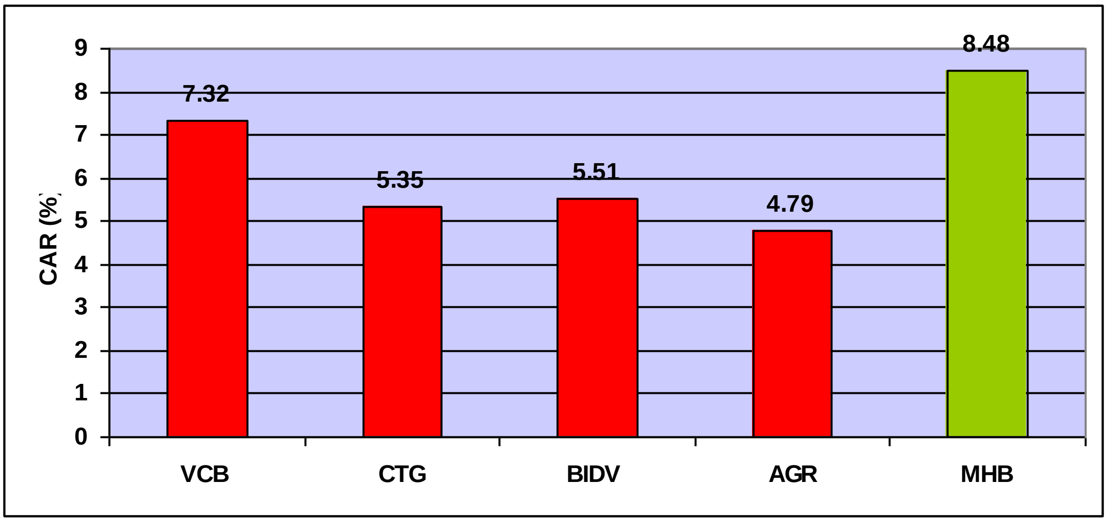
(2) The second stage started from 2006 to 2010 that was implementation phase of Decision No. 457/2005/QD-NHNN regulating safety assurance ratios in commercial banks' operations.

(3) Beginning in 2011, the third stage, which ended in 2012, is the phase of making ensure minimum capital adequacy of 9% in the spirit of Circular 13/2010/TT-NHNN regulating prudential ratios in activities of commercial banks.

4.2.2.1 Period of time from 1999 to 2005

At this stage, market share of five state-owned commercial banks including Vietcombank, Vietinbank, BIDV, Agribank, MHB, accounted for 70-75%. Also, in 2000, when facing with situation of too high bad-debt ratio, it led to the risk of bankruptcy in the state-owned banks. The government issued 12,000 billion in the form of special bonds with a period of 20 years to raise its own capital for the four of state-owned commercial banks. It contributed to increase total of their own capital to 18,000 billion VND, accounting for 51% of the whole system's own capital. Therefore, it can be said that safety of this bank group will determine safety of the entire banking system in Vietnam. However, when looking at capital adequacy ratio (CAR) of five state-owned commercial banks on 31 December 2005, it can be seen that most of the state-owned commercial banks had not achieved requirement on minimum capital adequacy ratio of at least 8 %, except for MHB.

Figure 5 Capital Adequacy Ratio of the State-owned credit institutions on 31 December 2005



Source: State Bank of Vietnam (2006)

However, if reviewing the entire banking system, it could be noticed that while the state-owned commercial banks had trouble in reaching capital adequacy standards, joint-stock commercial banks met this level.

Table 6 **Capital Adequacy Ratio of Vietnam's Banking System up to 31** December 2005

	Total capital (billion VND)	CAR (%)
State-owned banks	617,786	4.1
Urban Joint-Stock Commercial banks	156,140	8.0
Rural Joint-Stock Commercial banks	3,043	24.0
Joint-venture banks	13,192	12.0
Branches of Foreign Banks	81,899	9.2
Total	872,062	5.5

Source: State Bank of Vietnam

Particularly, except for group of State-owned Commercial Banks with very low CAR being 4.10%, remaining groups had higher number for CAR compared to regulation. In which, Urban Joint-Stock Commercial Banks reached the level 8.00% which was just enough to meet regulation's requirement. For group of foreign banks and joint-venture banks' branch, they had CAR at 9.20% and 12.00%, respectively. Specially, Rural Joint-Stock Commercial Banks got CAR up to 24%. However, because of much higher market share and own capital ratio of group of State –owned commercial banks against remaining groups, so overall, it had had been very low at CAR of 5,5%. Moreover, although, Vietnam's commercial banks had attempted and almost all Joint-Stock Commercial Banks achieved CAR over 8%, but if calculating CAR under Basel standards, i.e. add capital for market risk and operational risk to denominator, it may be certain that amount of Vietnam's Commercial Banks to reach CAR over 8% at this stage would be very low.

4.2.2.2 Period of time from 2005 to 2010

In this phase, in general, CAR of Commercial Banks is over the prescribed level of 8%. Nevertheless, it is still previous stage's problem, i.e. the State-owned commercial banks have a great impact on the entire system but do not satisfy the requirements of Decision No.457. Of which, AGR does not reach CAR required, even at very low level throughout this second phase. Also, BIVD, CTG and VCB have moment to not satisfy requirement of capital adequacy of Decision No. 457/QD-NHNN and modified and supplement text related.

Table 7 CAR (%) of some Commercial Banks from 2006 to 2010

Year	2006	2007	2008	2009	2010
VCB	12.60	9.20	8.90	*7.64*	9
CTG	*5.18*	11.62	12.02	8.06	8.02
ARG	*4.90*	*7.20*	*7.9*	*4.86*	*6.09*
BIDV	*5.50*	*6.67*	*6.50*	*7.55*	9.32
TCB	17.28	14.30	13.99	9.6	13.11
STB	11.82	11.07	12.16	10.90	10.32
ACB	10.89	16.19	12.44	9.97	10.4
EAB	13.57	14.36	10.75	N/A	10.84

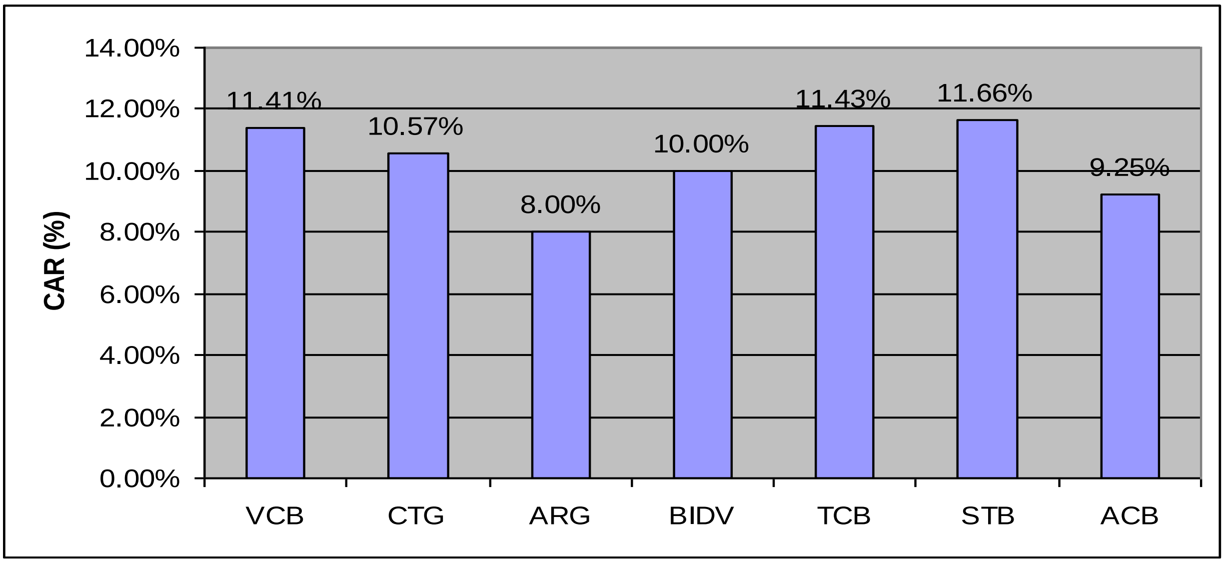
Source: State Bank of Vietnam (2011)

Period of 2006 and 2010 is an extremely fluctuated stage. Firstly, from 2006 to 2008, overall, most of banks have CAR over prescribed level and have growth trend. Since this is the favourable phase of business environment as well as the boom of stock market. However, from 2008 to 2009, due to impact of stimulus policies as well as the implementation of monetary easing by the central bank to commercial bank credit has increased sharply. This leads to the consequences of risky assets of commercial banks increased and as a result, the banks in the group tend to decrease its capital adequacy ratio. In particular, CAR of VCB drops to 7.64% from standard level of over 8%. After that, from 2009 to 2010, CAR of most of banks increases significantly. Since based on Decree No. 141/2006/ND-CP issued in November 22nd 2006, in the end of 2010, Joint-Stock Commercial Banks have to reach a minimum of legal capital level of three thousand billion VND. A number of banks have raised legal capital level according to regulations to ensure a minimum of CAR. Therefore, the own capital had been increased, i.e. numerator in CAR formula increases leading to increase dramatically this ratio.

4.2.2.3 Period of time from 2011 to 2012

During this period, perspective of ensuring capital adequacy is quite complicated. If looking at calculation of the entire system, system of Vietnam's Commercial Banks have secured minimum CAR at 9% according to Circular No. 13/2010/TT-NHNN. Firstly, there are good signs when most of Commercial Banks achieve more than 9%, though Agribank just reach to 8%. However, this is positive sign because AGR is also satisfied in comparison with Basel I, Basel II and Basel III's standards.

Figure 6 CAR of some Commercial Banks in 2011



Source: State Bank of Vietnam

The second notable sign is to, considering the whole banking system, CAR has growth trend, from 11.92% in September 2011 to 13.7% in October 31 2012. One of causes is effort of Joint-Stock Commercial Bank to implement under Decree No. 141/2006/ND-CP on increasing charter capital to over 3.000 billion VND. Up to October 31 2012, there is no bank with charter capital of less than 3.000 billion VND.

Table 8 **Capital Adequacy Ratio of Vietnam's Banking System**

	9/2011	31/10/2012
CAR (%)	11.92	13.7

Source: State Bank of Vietnam

However, with two above signs, it cannot be concluded that Vietnam's Commercial Banks are ready to deal with potential risks due to the following causes:

(1) Although, being the largest bank in Vietnam in term of capital, asset as well as staff, operation network and number of customer, Agribank still can not achieved a minimum capital adequacy level of 9% in 2011 as regulated. Even though, after that, CAR of Agribank grows up to 9.5% in March 2012 thanks to government's capital, but it is just slightly higher than the minimum requirement. Besides, the decline in loans quality remains a major risk for capital at perspective of Agribank's weaknesses in asset quality in asset quality and limited ability in creating internal capital. This is worrisome if in term of systemic risk. It is because the fall of AGR will lead to the collapse of banking system.

(2) For Joint-Stock Commercial Banks, all large banks tend to achieve new requirements on CAR of the State Bank. In reverse, small Joint-Stock Commercial banks are really in trouble in facing with requirement of raising the own capital for safety. In particular, in June 31, 2011, the level of CAR in ACB, Sacombank, Eximbank, Techcombank, East Asia, MB has reached over 9% in the spirit of Circular No. 13/2010/TT-NHNN. At that time, in November 2011, there are five Joint-Stock Commercial Banks to not reach a minimum CAR. Reviewing in the spirit of Decree No. 141/ND-CP issued by Government on November 22nd, 2006, in the end of June 2011, there are fifteen Joint-Stock Commercial Banks to have a charter capital of less than 3.000 billion VND, mostly at 2.000 billion VND. Therefore, even delaying

progress for a year, some of small banks still cannot to satisfy regulations on securing legal capital level. Although, then, in October 21st, 2012, all banks meet requirements of Decree No. 41/2006/ND-CP but it is obviously to classify banking groups in the banking system. There are potential risks from group of these small banks to affect to the whole system.

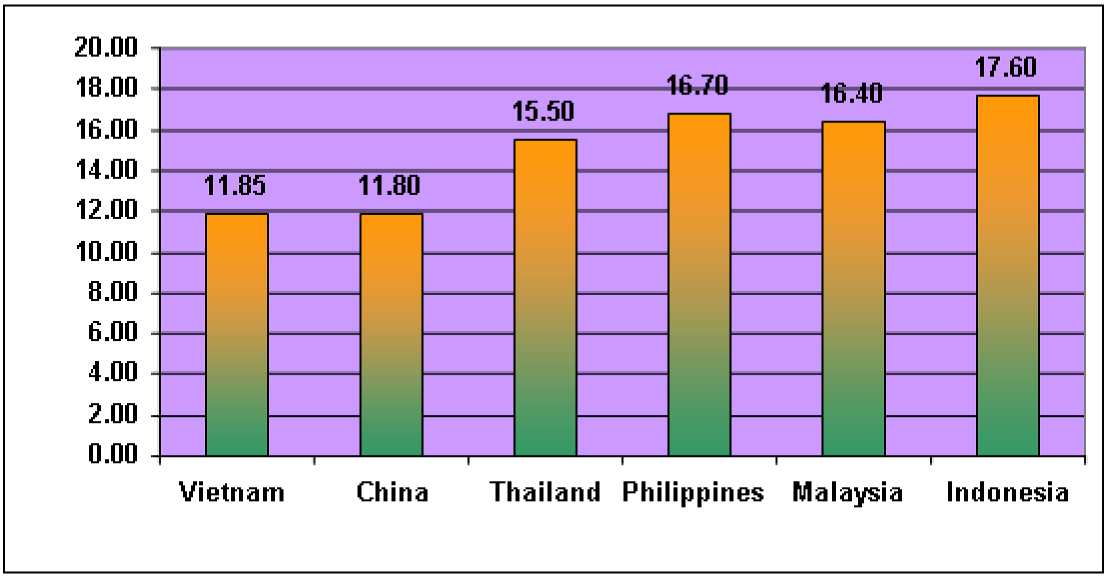
(3) Moreover, as Basel III's recommendation, in the situation of stable CAR, highly increasing leverage ratio also warn potential risks in the system of commercial banks. For Joint-stock commercial bank, trend of high financial leverage ratio is able to recognize clearly.

(4) In this period, real estate market declines and a lot of insolvent maturity debts have negative influence to bank's business operations. Therefore, liquidity situation is decreased and banks have to switch such debts into other groups as well as make provision of risk. The State Bank of Vietnam announces ratio of bad debt at 6% of outstanding loans for the whole banking industry in 2012. However, this figure has not yet accurately reflected a situation of credit risk in Vietnam's banking system due to standard of debt classification as well as loan classification has had been inadequate. If this process complies with international standard and precisely evaluates value of mortgage assets for loans such as the percentage of 53% in case of real estate, provision cost will increase and the own capital of banking system will be considerably corroded.

(5) Considering the aspect of the entire banking system, CAR of the entire commercial banks reach over 9%. However, it has not yet shown the level of sufficient capital of commercial banking system. This is because of denominator under Circular No. 13/2010/TT-NHNN just includes credit risks rather than taking into account market risks and operational risks. Moreover, according to Basel III, denominator also consists of risks generated by micro-economic fluctuation called as cyclical risks and crossover risks in case banks operate under the mode of financial group. If reviewing the situation of Vietnam, both of cyclical risk and crossover risk should be

counted. Furthermore, capital adequacy level of commercial banks in Vietnam is quite low when assessing the relationship with other banks in the region.

Figure 7 CAR of system of Credit Institutions in Vietnam and some regional countries in September 2011



Source: State Bank of Vietnam

REMARKS:

For classification and determine of debt

In comparison with Basel Committee's recommendation, clarification and define of bad debt of Vietnam's commercial banks are still quite large distances. Specially, as follows:

Firstly, for provisions oriented by management agencies, Vietnam's State Bank has not clearly oriented to the application of Basel II standards. Particularly, risk classification has not yet been detailed to correspond to loans. Risk coefficient has not yet corresponded to credit rating of borrower. Therefore, Vietnam suffers from Basel I's limitations that commercial banks have the same CAR but face with entirely different risk levels. Since then, banking monitoring body cannot accurately assess the level of credit risk of each commercial bank as well as the whole system.

Secondly, commercial banks themselves are also not voluntary in governing actual credit risk in their banks as well as in reporting on credit adequacy to management body and market. According to Basel II's regulations, there is no bank to apply IRB method and preparation roadmap for IRB method remains unclear. At the present, commercial banks only apply standardized method in clarifying debt between Basel I and Basel II. Accordingly, commercial banks have started to adopt system of credit rating to evaluate customer. However, problem is that the application in case of Vietnam's commercial banks is in preliminary level. Specifically, the system exposures the following troubles: Firstly, input database, which exposed from customers and banks in order to rate, is not insufficient and inaccurate, and then leads to really unreliable results. Besides, slowing in updating rating system results in backwardness of many targets, for example customers with high income of over 120 million per year was suitable for 2005 but completely obsolete in 2011. Moreover, qualitative criteria are not clearly developed. For instance, defining grading method of criteria "Leadership of enterprise" of most of banks are groundless to specific calculation. Furthermore, determining the scale to distribute the creditworthiness of borrower from AAA to B is subjective and there is no reference of independently trustworthy credit rating agency.

Administration of liquidity risk in comparison with the Basel ***Committee's recommendations***

If basing on process of liquidity management recommended by Basel Committee, administration of liquidity risk of Vietnam's commercial banks has not yet approached most of recommendation. Under principle no. 14 of "Good practices on liquidity management in banking organizations" issued by the Basel Committee, Vietnam's commercial banks have not conducted well the following content such as (i) build management structure of affordability; (ii) manage and approach market; (iii) establish contingency plan; (iv) manage affordability of foreign currency; (v) strengthen the publicity of liquidity. Pursuant to survey result of author, there is only ten percent of domestic commercial banks to deploy ''stress test" method which recommended in Basel II, to govern liquidity risk. Moreover, twenty five percent of Vietnam's commercial banks surveyed also assess that level of measurement and prevention of liquidity risk only limited at "average" level.

Administration of interest rate risk

Difficulties, which commercial banks encountered by fluctuation of interest rate in the period of 2008 and 2011, showed inadequacies of administration of interest rate risk in Vietnam's commercial banks. Comparing to the Basel Committee's recommendations, the clearest disadvantage of Vietnam's commercial banks is to not have suitable tool to quantify risks. Moreover, commercial banks seem to not have roadmap of building "stress test" method to determine level of appropriate capital adequacy in the worst case in situation of market stress.

4.2.3. BANKING SUPERVISION UNDER BASEL STANDARDS

The system of financial supervision of Vietnam is organized under dispersion model with a participation of the five agencies including the Banking Inspection and Supervision Agency called as the State Bank of Vietnam, the National Financial Supervisory Commission, the Deposit Insurance of Vietnam, the Insurance Supervisory Authority known as Ministry of Finance and the State Securities Commission of Vietnam. In which, each of them has their own specialization, technique and operates under different regulations, standards and principals. Bodies of supervising execution are through process of input selection, i.e. licensing, inspection; periodic surveillance of business activities, particularly, control, investigation and sanctions; as well as leave of the market, i.e. suspension or elimination of organization. This supervision model is appropriate when Vietnam's financial market has not yet developed. However, due to strong development of Vietnam's financial market in recent period, model above is no longer suitable. With appearance of financial group, multifunction banks as well as high complexity level of financial products, the model of institutional monitoring has revealed lots of limitations.

First and foremost, banking supervision system of Vietnam could not efficiently handle monitoring requirements of new financial products under integration trend in Vietnam's commercial banks. Particularly, there are integration products between banks and insurance, banks and securities as well as modern derivative products and traditional products in case of funding risky business areas such as real estate and security. In many instances, the appearances of integration products made monitoring bodies in financial safety network to be unable to know accurately which agency will be in charge of monitoring.

Secondly, there are a lot of limitations in sharing information as well as coordinating among bodies in financial safety network in supervising multifunction banking activities and financial group. This causes duplication of monitoring identical or similar activities among supervising agencies or "vacating" areas of supervision, especially multifunction banking operations, thus creating potential risk to waste resources or systematic risk. This is most apparent in the occurrence of severe loss situation of security companies and financial leasing companies belonged to parent companies, which are commercial banks. Risk level of Vietnam's financial groups is shown clearly through loss situation of Vietnam's financial leasing companies.

Moreover, crossover risk from security area to banking activities is reflected through relationship among security companies and commercial banks. According to financial statement, balance of gross loans of Security Company was no less than 10,000 trillion VND up to the end of 2010 (Nguyen, 2011). At that time, according to many experts, actual loan of Security Company might be higher due to a lot of security companies are lending under type of short –term investment contract or other items in financial statement. In the system of finance which most of security companies either is subsidiaries or is closely associated with commercial banks, collapsing security companies is extremely dangerous issue not only for investors, banks but also for the entire society. Clearly, clarifying responsibility of supervising bodies in causing establishment and development of crossover risks has been concerned by researches as well as the whole society.

Moreover, experts believe that most of central banks in other countries also combine using the two methods such as on-site inspection and off-site supervision. Using both of them helps administration bodies to monitor usually real situation of activities in credit institutions, as well as understand financial situation, especially factors which can lead to risk, unsafe system to timely handle serious problems occurred and prevent the spread in the system.

In fact, remote surveillance has been conducted by supervision center of banks. However, according to experts, supervision under this method has not achieved high efficiency due to some causes. The first cause is that operation of remote supervision has not fully compliant with Basel's twenty-five principles of supervision. Another reason is that an ability to meet information requirement for monitoring is limited by lack of information, inadequacy in process of receiving information and etc. Specially, there is a lack of early warning system, system of grading and rating credit institution according to CAMELS standards to support remote supervision.

Basing on legal document issued by the State Bank of Vietnam, it is able to assess the compliance with principles of banking supervision of the Basel Committee under three levels. In which, supervision of Vietnam's banks fully comply with only 6 over 25 principles and partly comply with 11 over 25 principles, equivalent to 24% and 44%, respectively, but the remainder has not been implemented being equal to 32%.

Table 9 Rating compliance with the core principles of banking supervision

No.	Principles	No compliance	Partial compliance	Full compliance
1	Objectives, independence, powers, transparency and cooperation		X	
2	Permissible activities		X	
3	Licensing criteria			X
4	Transfer of significant ownership			X
5	Major acquisitions			X
6	Capital adequacy			X
7	Risk management process		X	
8	Credit risk		X	
9	Problem assets, provisions and reserves		X	
10	Large exposure limits			X
11	Exposures to related parties		X	
12	Country and transfer risks	X		
13	Market risks	X		
14	Liquidity risk		X	
15	Operational risk	X		
16	Interest rate risk in the banking book	X		
17	Internal control and audit		X	
18	Abuse of financial services			X
19	Supervisory approach	X		
20	Supervisory techniques		X	
21	Supervisory reporting		X	
22	Accounting and disclosure		X	
23	Corrective and remedial powers of supervisors	X		
24	Consolidated supervision	X		
25	Home-host relationships	X		
	TOTAL	8	11	6

4.2.4. INFORMATION TRANSPARENCY COMPARED TO RECOMMENDATIONS OF BASEL AGREEMENTS

According to spirit of Basel II in third pillar, Vietnam's commercial banks issued Circular No. 35/2011/TT-NHNN specified the publication and supplement of information of the State Bank. Circular No.35 stipulates portfolio of information announced in the website of the State Bank of Vietnam with specific periodic and notice period. In comparison with information announced at present, this portfolio has added nearly twenty types of information about happenings of currency and operation of banking system, in which, there are core indicators such as minimum CAR, rate of bad debt over total of outstanding loans, outstanding loan of each sector in the total outstanding loan, revenue over total asset and revenue over equity of Vietnam's banking system. Conducting Circular No. 35/2011/TT-NHNN is proclamation for people, investors and partner countries to know more information about activities of Vietnam's banking system. Therefore, the more information means that ability of risk warning, if possible, will be much better. Then, investors, international organizations and people are entirely possible to supervise banking activities together.

However, if considering under the pillar 3 of Basel II, it strengthens market's role in ensuring safe and sound operations of banking system. The Basel Committee asks banks to public information of capital structure, risk level in banking operations and policy of risk management, solutions for risk restriction and etc. For content of information which needs to public, the Basel Committee set out many different requirements with quantitative and qualitative nature. For problems mentioned above, Circular No. 35/2011/TT-NHNN has not yet specific provisions.

SECTION 3: CAUSES, DIFFICULTIES IN FULL COMPLIANCE WITH BASEL STANDARDS

4.3.1 Shortcomings in legal framework

Number of legal documents as a basis to conduct banking supervision is much but not detailed and specific. Besides, system of administrative sanctions in financial market is low, incompetent to deter and prevent acts of recidivism and violation. In addition, legal environment of Vietnam has unsuitable characteristics to build effective legal framework in monitoring banking activities. In developed financial market, application system is common law in which allow to apply "case law" to deal with cases and violations in financial market. This legal environment enables to provide generally the most on violations in financial market in regulatory documents, therefore, system of law execution has an absolute flexibility in recognizing and dealing with violations in financial market. Meanwhile, Vietnam's law system is 'civil law". This system stipulates that financial management bodies can only conclude officially any object's violations if their behaviour or financial transaction are specified detailed in certain law document. However, characteristics of abuse of financial market are diverse, complicated and constantly changing. Therefore, legal framework of "Civil Law" is hard to keep up with development of these behaviours, resulting in effective of detection and treatment of behaviours and market abuse is not high.

4.3.2 The difference in Vietnamese Accounting Standards and IFRS

Another difficult is related to reporting standard. At the present, Vietnam's commercial banks are confusing in implementing under Accounting Standards of Vietnam called as VAS and International Finance Reporting Standards. As report made by the two standards or hiring independently domestic and oversea credit rating organizations, the evaluation result are very different. For example, balance sheet of Bank for Investment and Development of Vietnam is an example when hiring Moody's credit rating organization to rank. This issue indeed causes great difficulty for Vietnam's Banks in applying standards set out by Basel II.

Table 10 Some figures of BIDV based on VAS and IFRS

(Unit: million VND)

Targets of BIDV	IFRS		VAS	
	2007	2006	2007	2006
Total Asset	200,260	158,064	203,539	161,160
Own capital	7,888	4,181	11,266	7,341
Own capital/ Total Equity	3.94%	2.64%	5.53%	4.55%

Source: BIDV (Annual report, 2007)

4.3.3 The lack of credit rating agencies

One of difficulties, if considering application of Basel II in risk management in Commercial Banks of Vietnam, is shortage of high-quality human resource. This is common issue for all commercial banks including supervision bodies of Commercial Banks such as State Bank of Vietnam. Based on researching Basel II's standards, it can be seen that experts in governing, monitoring and supervisors of banks are forced to have certain knowledge, particularly, to be good at language as well as math and administration knowledge in order to understand and use such standards. Moreover, analysis and forecast skills are also indispensible skills. There are high requirements to Vietnam' banking experts at this time. Although, banking human resources is not lacking, even redundant but there is not much to these stringent requirements. Furthermore, there are excellent experts who are in charging of important positions in commercial banks, but due to lacking of conditions and times to be training and approaching these new knowledge, therefore, they have not yet been able to apply in actual work. Cost for courses with foreign experts in finance and banking industry is generally quite high and takes time together with learner's effort.

4.3.4 Restrictions on high-quality human resources

Another difficulty should be mentioned is to lack of professional credit rating bodies. Since, according to Basel II, commercial banks have to base on a lot of factors to define risk ratio for each term of related asset related to each group of different subject. One of these factors is result of creditility ranking of independence credit rating bodies. In fact, banks are taking steps to build credit rating system for each group of customers. However, this credit rating is mainly for process of evaluation and lending decision of banks process but rarely for sharing or publishing widely. Thereby, evaluation results are highly subjective and emotional factors rather than objective elements. Besides, it leads to inaccurate conclusion due to lack of information.

In Vietnam, there are currently three organization considered to be the most professional bodies in operations of credit rating but they have not been recognized by international organization and have not done proper function of credit rating bodies. Firstly, Credit Information Center of State Bank of Vietnam (CIC) not only functions in collecting and providing credit information for State Bank of Vietnam but also rates corporate credit under Decision No. 473/2004/QD-NHNN. Secondly, Vietnam Credit Information and Rating Company, newly established in 2004, is separated from Vietnam Solution Company, which is the first private company in Vietnam in supplying credit reports based on evaluation standards of major organization in the world such as Standard & Poor's, Moody's and etc. Lastly, Credit Rating Vietnamnet called as VRC of VASC Software and Media Company called as VASC was established in June 4th, 2005.

Nevertheless, such organizations are not credit rating bodies in the true sense due to main operations are to provide only information relevant to businesses without doing operation of credit rating under international standards. Therefore, in order to build database which really big enough, diverse, quality and widely accepted, it is necessary to take a considerable period of time. Moreover, these organizations are temporarily using other organization's standards and rating system but are not able to build system of unified criteria for Vietnam. Such loan will also somewhat cause difficulty in the application to calculate for Vietnam enterprises.

4.3.5 Other factors

In addition, many other difficulties affecting the application of Basel Accords in Vietnam as the management of the bank supervisory authority is weak, the cost of applying Basel is quite high , IT systems are limited, database systems have not built and etc.

SECTION 4: SOLUTIONS FOR IMPROVEMENT AND DEVELOPMENT OF VIETNAM'S BANKING SYSTEM

4.4.1 Improving human resource's quality

First of all, it is necessary to timely train available human resource such as managers, supervisors of the State Bank and commercial banks as well as credit officer to meet immediate demands. Particularly, the State Bank of Vietnam should cooperate with commercial banks to hold training courses to foster and update knowledge for managers in order to improve their ability in assessing, measuring, analysing and controlling credit risk. Specially, it should invite experts of the Bank for International Settlements for intensive training and sharing practical experience. Nevertheless, if considering medium and long term, it needs to train qualified workforces together with ability in anticipating trends of Vietnam's banking industry. In particular, it should limit number of universities with improper professional training due to quality must be placed on top instead of quantity. In this way, it can make the most of resources for training high- quality human resource on an international level.

4.4.2 Improving quality of credit rating

In the immediate future, in order to promptly meet demands for customer credit rating, each commercial bank needs to develop system of internal credit rating to ensure professionalism supporting risk management and policy of risk prevention, to define credit limits for customer and issue credit manuals. Moreover, commercial banks should consistent with one another on criteria for rating and sharing information of customer to have accurate and objective evaluation.

In the long run, it is necessary to establish independent credit rating company, especially focusing on the function for rating credit rather than announcing information as present. Moreover, for empowering international stature, Credit Rating Companies have to announce its solvency of debt for each ranking level for investors to see their confidence level of rating. In order to do so, credit rating companies need to collect data for years. Therefore, they must build data system by providing free rating service in the first few years. In addition, Vietnam has had basic and minimum legal framework for domestic credit rating activities since, there were few credit rating organizations. On the other hand, some large enterprises have hired service of the leading companies in credit rating when issuing bonds. Thereby, legal system needs to be specified for both credit rating companies and their customers.

4.4.3 Perfecting system of legal documents

The importance thing is to conduct successfully application of supervision process and risk management under Basel II and Basel III's standards in the future. In which, there are clear provisions on competence of organizations as well as clear definitions for terms or standards as a basis of risk analysis. Improving current banking accounting system under international standards, especially classification of debt based on quality over risk level, provisioning for credit losses and accounting income over expenses. It should coordinate with ministries to complete accounting system under International Accounting Standard, known as IAS/IFRS. Developing policy solutions to improve control method and internal audit in banks and proceed to international standards. Facilitating banks to apply modern administration technology and creating barriers against abuse and fraud with special attention to difference between USA accounting standard called as GAAP and international financial reporting standards called as IFRS in the consolidation trend of such two standards.

4.4.4 Other solutions

Beyond three solutions above, it should be combined synchronically technology, improving process of risk management, strengthening activeness and financial power for commercial banks, investing in finance area to apply Basel II and Basel III, improving quality of credit information, improving effective of the inspection and control of banks and etc.

CHAPTER 5: CONCLUSION

Banking system has an important role, is one of channel, which mobilize and regulate the main resource of economy and is also a major tool in implementing national monetary policy and economic management of the State. A stable growth and development of this system directly and strongly impact to growth of the whole economy. Especially, not only in a manufacturing sector but also new business areas such as electronic commercial, retail, security, and telecommunications and etc. depend heavily on banking services. Therefore, if there is any uncertainty, it will significantly affect to the entire economic activities. On the other hand, operations of Vietnam's commercial banks are very sensitive and potentially risky. Thereby, administration of banking operations in general and risk administration of commercial banks in particular are always a focus towards the whole commercial banking system not only in Vietnam but also in over the world.

At the present, strengthening quality of risk management in commercial banks is a pressing on both theoretical and practical areas. Therefore, it is necessary to understand reasons for anticipating and identifying reasonable countermeasures and remedies in order to improve administration level, which is also purpose of improving the operational efficiency of commercial bank. Since then, commercial banks have facilities to develop in a sustainable way. It contributes significantly to promote Vietnam's economy thriving more and more. Thus, this dissertation focus on studying systematically theoretical and practical issues of activities of Vietnam's banking system as well as Basel's standards. By which, it comprehensively assesses the safety level of the entire banking system under impact of current development trend based on applying recommendations of standards of international risk measurement.

First of all, this thesis generally introduces process of formation and development of Basel agreements as well as points out main content such as innovation, reform in each version of Basel.

Secondly, thesis focuses on studying comprehensively and systematically situation of Vietnam's banking system mostly in recent years. Analysis focuses on systematic risk of Vietnam's banking system, assessment of risk administration ability of commercial banks, supervision of management agencies. Such assessments basically rely on standard framework of Basel II and Basel III as well as bases on the comparison with ability to assess recommendations of the Basel Committee. Analysis above is based on statistic document from practical activities so they are high value for executive managers in Vietnam's practice.

Thirdly, through the analysis, thesis has drawn causes, difficulties and limitations in accessing and implementing international standards to improve Vietnam's banking system. On that basis, it also has provided directions and solutions in order to apply Basel Ii and Basle III to ensure that risk management in Vietnam's banking system is performed well.

In short, the thesis has solved thoroughly research questions as well as purposes proposed.

Furthermore, this thesis is completed under purpose of contributing a part of author's knowledge for completing Vietnam's banking system as well as adding material for intensive researching, teaching on area of supervision and administration of banking activities. However, due to limitation of data sources, it is certainly that shortcomings are inevitable. Author hopes to receive evaluations and suggestions from experts to more complete for thesis and to get deeper knowledge in this field of research.

CHAPTER 6: RECOMMENDATIONS

This researcher proposes building consolidated financial supervisory agency to implement monitoring function comprehensively for the banking system.

The trend of establishment of such monitoring agency is very popular all over the world; however, it is quite new for Vietnam market. The establishment of this system is consistent with the development of Vietnam's banking system. This model has proved the success in some countries by ensuring objectives of financial supervision system. The problem here is that the application needs to ensure feasibility and effectiveness. Therefore, improving the system of banking supervision in Vietnam up to 2020 should be implemented in two specific phases as follows:

(1) Period of 2013 and 2016 is the stage for consolidating effect of specialized supervision and preparing conditions for model of integrated supervision.

Table 11 Roadmap of building a model of financial supervision from 2013- 2016

	Implementation Roadmap	2013	2014	2015	2016
1	Build orientation model for agency of consolidated financial supervision.				
1.1	Build and improve strategies as well as objectives of agency of consolidated financial supervision				
1.2	Build and complete functions and tasks for agency of consolidated financial supervision				
1.3	Identify staff for Council of agency of consolidated financial supervision in the period of 2017 and 2020				
2	Build a system of legal documents as a basis for financial monitoring system				
2.1	Rebuild functions and tasks of the Banking Inspection and Supervision Agency				
2.2	Build decree on financial supervision				
2.3	Build circular on financial supervision				
2.4	Build handbook for inspecting and monitoring				
2.5	Build ordinances on financial supervision				
2.6	Build Decree on organization and operation of State Financial Supervision Committee				
2.7	Review law related to financial supervision				
3	Improve ability of specialized supervision agency and the National Financial Supervision Commission				
3.1	Complete technique on Inspection and Supervision				
3.2	Improve the level of human resources				
3.3	Improve IT systems and technical conditions				

(2) Besides, the period of 2017 and 2020 is the phase for improving consolidated supervision model. After ending the first phase from 2013 to 2016, supervision capacity of the specialized supervisory agencies should be raised, as well as meet the conditions for the development of the financial market. This is the most suitable time for conducting consolidate supervision model in 2020.

Table 12 Roadmap of completing a model of financial supervision from 2017 -2020

	Implementation Roadmap	2017	2018	2019	2020
1	Build State Financial Supervision Agency				
1.1	Establish State Financial Supervision Committee with clear rules of responsibility, authority and goals of each department				
1.2	Complete organizational structure				
2	Improve the National Financial Supervision Commission				
2.1	Promulgate standard set for evaluating the validity of supervisory activities				
2.2	Complete organizational model of National Financial Supervision Commission				
2.3	Implement standard set for evaluating the validity of supervisory activities				
2.4	Improve coordination mechanisms with the Department of Financial Intelligence				
3	Improve Human Resource				
3.1	Training to improve qualification				
3.2	Redeployment				
3.3	Reassign tasks				
3.4	Improve development mechanism of Human Resource				
4	Improve systems of information technology and infrastructure conditions				
4.1	Improve system of monitoring expenditure				
4.2	Consolidate system of information technology				
4.3	Consolidate and expand of infrastructure conditions				
5	Improve rules related to monitoring Vietnam's commercial banks				
5.1	Organize workshops and make final report of the legal system deployed in the period of 2017 and 2020				
5.2	Develop and promulgate the Law on Financial Supervision				
5.3	Edit and improve the laws relating to financial supervision				

With this roadmap, in 2020, I believe that, Vietnam will apply well provisions of the Basel Agreements. Furthermore, it will also ensure good implementation of goals set out for system of financial supervision such as stabilizing financial system, ensuring safety and soundness of financial institutions, protecting consumers of financial products and guarantee fair competition in the financial market.

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