

**Technical Assistance on  
Primary Dealership for Government Bonds in Vietnam  
Final Report**

March 2006

Prepared  
for  
Ministry of Finance of Vietnam  
and  
Ministry of Finance of Japan  
by

**NRI**   
Nomura  
Research Institute

## **Preface**

In response to the request by Ministry of Finance of Vietnam, this technical assistance was funded and provided by Ministry of Finance of Japan as part of ASEAN+3 Asian Bond Markets Initiative. The counterpart in charge was International Relations Department, in collaboration with Banking and Financial Institutions Department.

Nomura Research Institute, as a consultant, implemented this technical assistance and wrote this report. In fact, it benefited to a large extent from cooperation made by both public and private sectors of Vietnam. In particular, Ministry of Finance of Vietnam, State Bank of Vietnam and Ho Chi Minh City Securities Trading Center were kind enough to provide Nomura Research Institute with a wide range of database and other inputs. Nevertheless, possible errors, misunderstandings and mistakes shall fall under the responsibility of the author.

If this technical assistance and report contributes to strengthen and deepen the bond market in Vietnam, it is the deepest pleasure of us.

March 2006  
Nomura Research Institute

## Abbreviations

ADB	Asian Development Bank
DAF	Development Assistance Fund
DMO	Debt Management Office
DVP	Delivery versus Payment
HCMC	Ho Chi Minh City
MOF	Ministry of Finance
NRI	Nomura Research Institute
OMO	Open Market Operations
PD	Primary Dealership
PDs	Primary Dealers
SBV	State Bank of Vietnam
SOCB	State Owned Commercial Bank
SOE	State Owned Enterprise
SSC	State Securities Commission
STC	Securities Trading Center
T-bill	Treasury bill
TA	technical assistance
VBA	Vietnam Banking Association
VCB	Vietcombank
VCBS	Vietcombank Securities
VPSC	Vietnam Postal Savings Corporation
VSA	Vietnam Securities Association
VSS	Vietnam Social Security

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## **I. Section I: Findings and Recommendations**

### **1. Overview of Government Bond Markets**

#### **1.1. Legal and Regulatory Framework**

##### **1.1.1. Legal framework**

Decree No. 141/2003/ND-CP of November 20<sup>th</sup>, 2003 on issuance of government bonds, government-guaranteed bonds and local administration's bonds provides for the primary market of government securities. Decree 141 defines government bonds as "a type of debt securities, issued by the Government for given terms, with denominations and interests, certifying the Government's debt-repaying obligation towards bond owners." Under Decree 141, MOF has issued a number of its Decisions and Circulars to guide procedures in detail for issuing government bonds. Besides, SBV has also enacted a set of Decision and Circular on bidding of T-bill and foreign currency bonds, among six products of government bonds.

As for the secondary market, Decree No. 144/2003/ND-CP of November 28<sup>th</sup>, 2003 on securities and securities markets broadly provides for listing and trading of government securities as well as securities companies' businesses including reporting regime to STCs. Besides, SBV has stipulated a number of its Decisions regarding OMO, discount/rediscount, bond-collateralized lending, overdrafts and overnight lending, etc., almost all of which provide for trading of government securities between SBV and credit institutions.

##### **1.1.2. Regulatory framework**

Under Decrees 141 and 144, MOF provides for regulations on issuance and trading of government bonds at most. SSC, among a number of departments of MOF, serves as a regulator on secondary market in general, and STCs regulate details of reporting requirements to its member securities companies.

Besides, SBV regulates a variety of bond-related transactions between SBV and credit institutions as well as between credit institutions and their counterparties. SBV is a special member of HCMC STC, but is not required to report its bond-related transaction with credit institutions to STC.



## 1.2. Primary Market

### 1.2.1. Variety of government bonds

Decree 141 categorizes government bonds into six as follows:

- Treasury bills
- Treasury bonds
- Centrally-run works' bonds
- Investment bonds
- Foreign currency bonds
- National construction bonds

MOF assumes the responsibility of the issuance plans of government securities including Treasury bills, Treasury bonds, centrally-run works' bonds and foreign currency bonds. For these, MOF is to "work out plans for incorporation in the State budget estimates" (according to Decision No.66/2004/QD-BTC, hereinafter referred to as "Decision 66"). Among six types of government bonds, the issuance of national construction bonds is separately stipulated by Ordinance No. 12/1999/PL-UBTVQH10.

Usages of mobilized funds differ depending on the types of government securities. Among them, Treasury bonds and Treasury bills are issued to offset deficit of the State budget, whereas other types of government securities are issued for public works, investments and other public objectives.

Table & Chart 1-1: Usage of mobilized funds for each type of government bonds

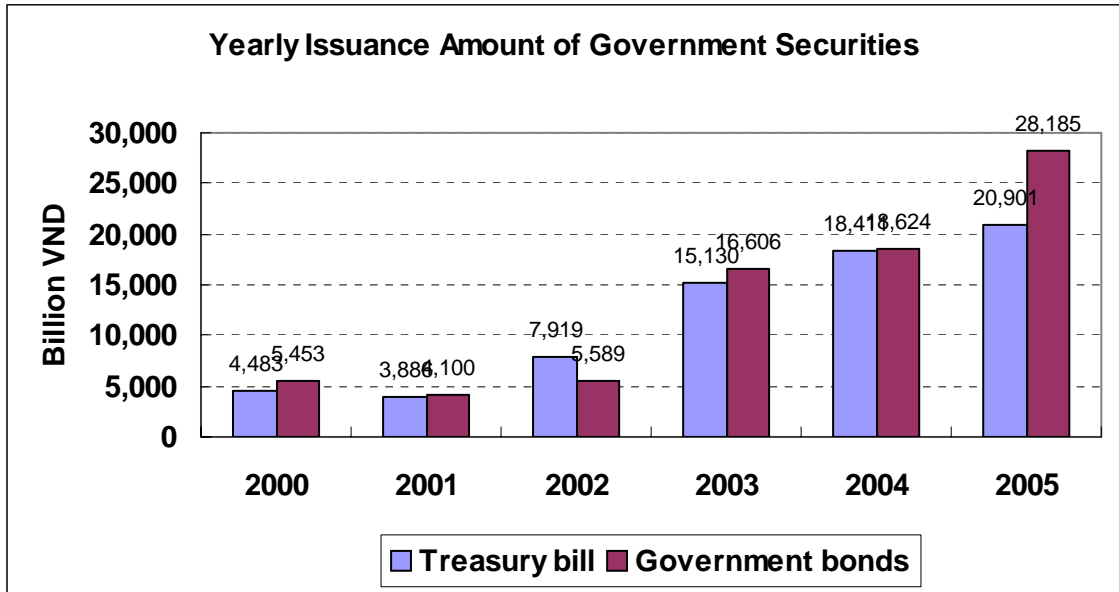
	Usage of funds
Treasury bills	To offset temporary deficit of state budget
Treasury bonds	To offset state budget deficit
Centrally-run works' bonds	Under the Prime Minister's decisions, for projects which are invested with central budget, have been included in plans but not yet provided with budget in the year
Investment bonds	For investment according to the Government's policies
Foreign currency bonds	Fore the objectives designated by the Prime Minister
National construction bonds	For investment in the construction of national important works and other essential works

Source: Author's schematization from Decree 141 and relevant Decisions and Circulars

MOF has steadily increased yearly issuance volumes of government securities since year 2000, reaching 20,901 billion VND for bills, and 28,905 billion VND for bonds in 2005. Compound annual growth rate of issuance volume is 38%, much higher than GDP growth, which indicates that debt-to-GDP ratio has also been increasing steadily.

On the other hand, outstanding volume as of yearend of 2005 reached 90.7 trillion VND (or 69.5 trillion VND excluding T-bills).

Table & Chart 1-2: Yearly issuance amount of government securities

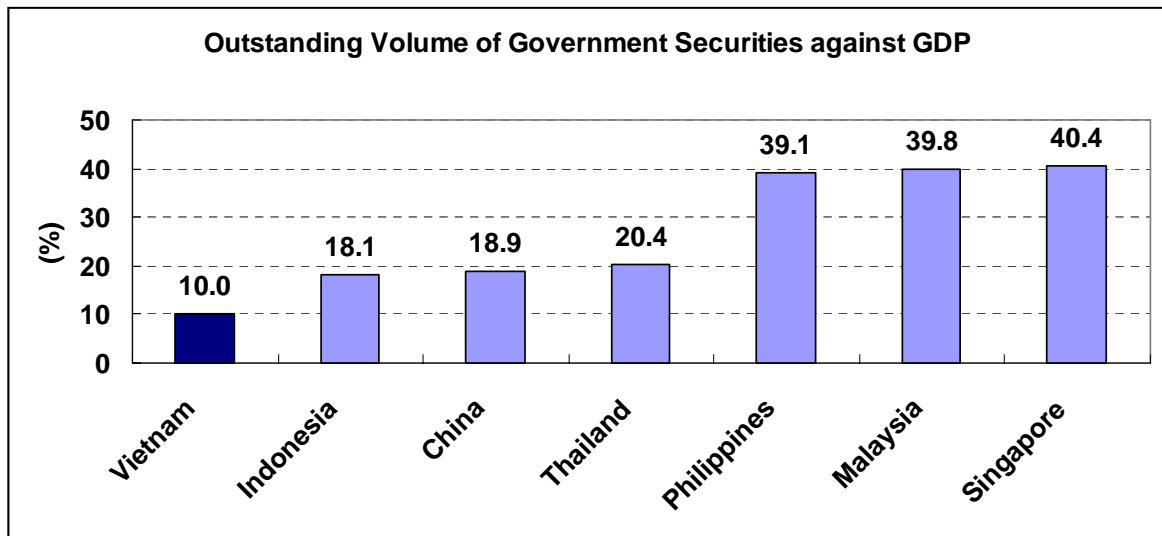


Note: Government bonds include Treasury bond, centrally-run works bond, investment bond, national construction bond and foreign currency bond.

Data source: MOF

Still, compared with other selected ASEAN+3 countries, ratio of government securities outstanding to GDP is still low at 10%.

Table & Chart 1-3: Outstanding volume of government securities against GDP



Note: as of June 2005

Data source: "Asia Bond Indicators," ADB Asian Bonds Online

### **1.2.2. Issuing organizations**

The issuing organization of Treasury bills, Treasury bonds, centrally-run works' bonds, national construction bonds and foreign currency bonds is the State Treasury, and the issuing organizations of investment bonds are State-run financial institutions, financial or credit organizations designated by the Prime Minister. Currently, only the DAF issues investment bonds.

For T-bills, MOF may “entrust the State Bank, State-run commercial banks” for issuance and repayment operations, and currently it delegates this function to SBV.

### **1.2.3. Issuance modes**

There are four types of issuance modes (channels) for government bonds, namely bidding (auction), underwriting, issuance agents and retail. Eligible channels are designated for each type of government securities.

Bidding (auction) is conducted either at SBV or STCs, and is applied to Treasury bills and foreign currency bonds (at SBV), Treasury bonds, centrally-run works' bonds and investment bonds (at HCMC and/or Hanoi STCs). In bidding, interest rate is determined uniformly at the highest bid-winning interest rate.

Underwriting means “underwriting organizations assisting the issuing organizations in carrying out procedures before issuing bonds into the securities market, distributing bonds to investors, undertaking to buy bonds for resale or to buy the remaining bonds not distributed up” (Decree 141). For each underwriting, issuing and underwriting organizations agree on the terms and conditions, including interest rate, underwriting charge, bond volume to be underwritten, minimum bond volume which must be distributed to investors, bond selling mode and other relevant matters (Circular 29). Underwriting organizations are required to distribute at least 50% of bond value they underwrite to investors.

Issuance agents mean “the other organizations entrusted by the issuing organizations to sell bonds to investors.” This channel is currently not used for government bonds.

Retail means “directly handing bonds and collecting money from every buying subject by the issuing organizations.” Although “retail” is the usual translation for the Vietnamese term “Ban le,” it does not necessarily mean that the buyers are only individuals (organizations are also eligible buyers, as explained later). Rather, this channel is characterized by “direct sales to end-investors” by the State Treasury.

Table & Chart 1-4: Government bond issuance modes

	Issuer	Issuance Modes				
		Bidding		Under- Writing	Agent	Retail
		SBV	STCs			
Treasury bills	State Treasury	X				
Treasury bonds	State Treasury		X	X	X	X
Centrally-run works' bonds	State Treasury		X	X		X
Investment bonds	State-run financial institutions, financial or credit organizations		X	X		X
Foreign currency bonds	State Treasury	X				X
National construction bonds	State Treasury	--	--	--	--	--

Note 1: X: Stipulated by Decree 141, --: Not specifically stipulated by Ordinance 12.

Note 2: In practice national construction bonds are retailed by the State Treasury.

Source: Author's schematization from Decree 141 and Ordinance 12

In year 2005, T-bills had the largest volume of issuance among government securities, followed by Treasury bonds and centrally-run works' bonds. The major modes of issuance for Treasury bonds, centrally-run works' bonds and investment bonds were underwriting and retail, followed by bidding (auction) at STCs.

Table & Chart 1-5: Annual issuance of government bonds (2005)

		Auction through SBV	Auction through STC	Underwriting	Retail	Total
1 Treasury bill	Up to 1 year	20,901	-	-	-	20,901
	(Percentage)	100%	0%	0%	0%	100%
2 Treasury bond	(Subtotal)	-	2,185	6,795	2,479	11,459
	(Percentage)	0%	19%	59%	22%	100%
3 Centrally-run works bond	(Subtotal)	-	50	3,150	7,385	10,585
	(Percentage)	0%	0%	30%	70%	100%
(Treasury and Centrally-run works bond)	2 year	-	-	586	-	586
	3 year	-	-	275	-	275
	5 year	-	2,235	8,369	-	10,604
	10 year	-	-	320	5,500	5,820
	15 year	-	-	395	-	395
	Unknown	-	-	-	4,364	4,364
	Discrepancy	-	-	-	-	-
	(Subtotal)	-	2,235	9,945	9,864	22,044
(Percentage)	0%	10%	45%	45%	100%	
4 Investment bond	2 year	-	-	230	-	230
	10 year	-	-	1,025	-	1,025
	15 year	-	75	1,690	-	1,765
	Unknown	-	-	-	-	-
	Discrepancy	-	55	250	-	305
	(Subtotal)	-	130	3,195	-	3,325
(Percentage)	0%	4%	96%	0%	100%	
5 Natinal construction bond	2 year	-	-	-	2,816	2,816
	(Subtotal)	-	-	-	2,816	2,816
	(Percentage)	0%	0%	0%	100%	100%
6 Foreign currency	(Subtotal)	-	-	-	-	-
	(Percentage)	0%	0%	0%	0%	0%
<b>Total</b>	Up to 1 year	20,901	-	-	-	20,901
	2 year	-	-	816	2,816	3,632
	3 year	-	-	275	-	275
	5 year	-	2,235	8,369	-	10,604
	10 year	-	-	1,345	5,500	6,845
	15 year	-	75	2,085	-	2,160
	Unknown	-	-	-	4,364	4,364
	Discrepancy	-	55	250	-	305
	(Total)	20,901	2,365	13,140	12,680	49,086
(Percentage)	43%	5%	27%	26%	100%	

Data source: MOF

Similar trend can also be observed from the outstanding amount, with T-bills and Treasury bonds having the largest outstanding amount. Major issuance modes for Treasury bonds, centrally-run works' bonds and investment bonds are retail and underwriting, while bidding (auction) comprises only a small portion.

Table & Chart 1-6: Outstanding amount as of yearend 2005

	Type of bond	Auction through SBV	Auction through STC	Underwriting	Retail	Total
1	T-bills	20,901 100%				20,901 100%
2	Treasury bonds		4,437 16%	9,148 33%	14,141 51%	27,726 100%
3	Centrally- run work bonds		1,171 6%	5,215 27%	13,054 67%	19,440 100%
4	Investment bonds		1,324 8%	14,674 92%		15,998 100%
5	National construction bonds				5,382 100%	5,382 100%
6	Foreign currencies bonds	232 19%			1,006 81%	1,238 100%
	<b>Total</b>	<b>21,133</b> <b>23%</b>	<b>6,932</b> <b>8%</b>	<b>29,037</b> <b>32%</b>	<b>33,583</b> <b>37%</b>	<b>90,685</b> <b>100%</b>

Unit: Billion VND

Data source: MOF

#### 1.2.4. Ceiling interest rates

Decree 141 stipulates rules on interest rates for each type of government bonds, as in the following table. In general, interest rates are to be determined by the Finance Minister periodically (Decision 66), and currently are reviewed and set on a monthly basis for each tenure. Same rate is applied for Treasury bonds, centrally-run works' bonds and investment bonds.

Under Decree 141, these rates (hereinafter referred to as "ceiling rates") do not necessarily apply for bonds auctioned at STCs or SBV. However, due to the following regulations, ceiling interest rates practically apply for auctions as well.

- Decision 66 stipulates "the Finance Ministry shall suspend the issuance when "interest rates of issued bonds exceed the ceiling rate or interest rate amplitude announced by the Finance Ministry (Article 12)," which seems to apply regardless of issuance modes.
- Circular No.21/2004/TT-BTC (guiding the bidding for government bonds and others) stipulates "the Finance Minister shall announce the ceiling interest rate in each period" (although ceiling rate "may not be prescribed" depending on specific conditions).

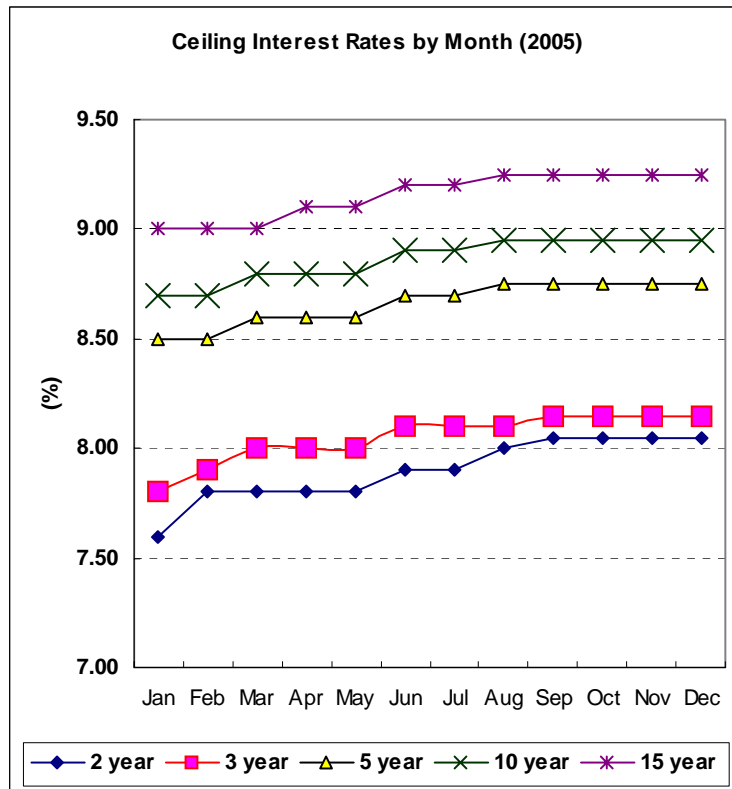
Table & Chart 1-7: Interest rate setting methods by type of government bonds

	Interest rate setting method
Treasury bills	➤ The volumes and interests of T-bills shall be formulated through bidding results. (Article 19, Decree 141)
Treasury bonds	➤ Treasury bond interests shall be decided by the Finance Minister on the basis of the practical situation of the financial market at the time of issuance. In case of bidding for interests, the interests shall be formulated according to the bidding results. (Article 25, Decree 141)
Centrally-run works' bonds	➤ The interests on centrally-run works' bonds shall be decided by the Finance Minister on the basis of the practical situation of the financial market at the time of issuance. In case of bidding for interests, the interests shall be formulated according to the bidding results. (Article 32, Decree 141)
Investment bonds	➤ The Finance Minister shall decide on the ceiling interest rate on investment bonds for each period on the basis of the practical situation of the financial market and the issuing organizations' demands for capital mobilization. In case of bidding for interests, the interests shall be formulated according to the bidding results within the ceiling limit already decided by the Finance Minister. (Article 37, Decree 141)
Foreign currency bonds	➤ The Finance Minister shall decide on the issuing time, currencies, level, interest rates, denominations and terms of foreign-currency bonds. (Article 43, Decree 141)
National construction bonds	➤ The specific interest rate for each issuance of bonds shall be prescribed by the Government (Article 10, Ordinance 12)

Source: Author's schematization from Decree 141 and Ordinance 12

Following is the ceiling interest rates of Treasury bonds, centrally-run works' bonds and investment bonds for each tenure during year 2005.

Table & Chart 1-8: Ceiling Interest Rates by Month (2005)



Data source: VCBS



### 1.2.5. Eligible participants to the primary market

Subjects entitled to be bidding members, underwriters or buyers of each type of government securities are stipulated in Decree 141. Further, the following regulations stipulate the eligibility criteria to be participants in each issuance modes:

- Decision No.29/2004/TT-BTC (underwriting and agent issuance)
- Decision No.111/2004/QD-NHNN (foreign currency bonds)
- Circular No.19/2004/TT-BTC (T-bills and foreign currency bonds)
- Circular No.21/2004/TT-BTC (bidding)
- Circular No.32/2004/TT-BTC (issuance through State Treasury System)
- Ordinance No. 12/1999/PL-UBTVQH10 (national construction bonds)

Following table shows eligible participants for each type of government securities.

Table & Chart 1-9: Eligible participants by type of government bonds

	T-bills	Treasury bonds, centrally-run works' bonds and investment bonds			Foreign currency bonds		National construction bonds
	Bidding	Bidding	Underwriting	Retail	Bidding	Retail	Retail
Credit institutions	X	X	--		X		X
Banks			X				
Finance companies			X				
Insurance	X	X			(X)		X
Investment funds	X	X	X		(X)		X
Foreign investment fund branches	X	X			(X)		X
Securities companies		X	X				X
Other financial institutions			X				X
Enterprises, economic organizations		X		X		X	X
State Bank	X						X
Political, socio-political, socio-political-professional, socio-professional org.				X		X	X
Vietnamese citizens				X		X	X
Foreigners working and residing in Vietnam				X		X	X

Note 1: X: Eligible, --: Not specifically stipulated.

Note 2: Insurance includes insurance companies and insurance funds.

Note 3: (X) for foreign currency bonds means: eligible according to Circular 19, but not eligible according to Decision 111.

Source: Author's schematization from Decree 141, Ordinance 12, etc.

In year 2006, following institutions are the designated participants in underwriting and issuance agents for government securities.

Table & Chart 1-10: Eligible underwriters of government bonds (2006)

<b>I.</b>	<b>Commercial Banks</b>
1	Vietcombank
2	Agriculture and Rural Development Bank
3	Industrial Commercial Bank
4	Investment and Development Bank
5	Ho Chi Minh Housing Development Commercial Bank
6	Sai Gon Industrial Commercial Bank ( Sacombank)
7	Phuong Nam joint Stock Commercial Bank.
8	Standard Chartered Bank, Hanoi
<b>II.</b>	<b>Securities companies</b>
1	Securities company of Investment and Development Bank
2	Securities company of Asia Commercial Joint Stock Bank
3	Thang Long securities company
4	Vietcombank securities company
5	Securities company of Agricultural and Rural Development Bank
6	Bao Viet securities company
7	Ho Chi Minh Securities company
8	De Nhat Securities company
9	Securities company of Industrial Commercial Bank

Source: Decision No. 10 /2005/QĐ-BTC and Decision No. 795/QĐ-BTC

In addition, for bidding at STCs, STCs are to review and determine the eligibility conditions on an annual basis (Circular 21). In year 2005, following institutions were the auction members at Hanoi and HCMC STCs.

Table & Chart 1-11: Government bonds auction members at STCs (2005)

<b>HCMC STC</b>		
1.	Incombank	NH01
2.	Housing Development Bank	NH02
3.	Vietcombank	NH03
4.	BIDV Nam Ky Khoi Nghia branch	NH04
5.	Eximbank	NH05
6.	Sacombank	NH06
7.	Vietnam Social Security	NH07

8.	Manulife Vietnam	NH08
9.	Prudential Vietnam	NH09
10.	Phuong Nam Bank	NH10
11.	PetroVietnam Finance Company	NH11
12.	AIA Insurance company	NH12
13.	Deutsche Bank, HCM branch	NH13
14.	Ho Chi Minh Securities company	CK01
15.	Vietcombank Securities company	CK02
16.	Bao Viet Securities Company	CK03
17.	BIDV Securities company	CK04
18.	Incombank Securities company	CK05
19.	Agribank Securities company	CK06
20.	Hai Phong Securities company	CK07
21.	ACB Securities company	CK08
22.	Saigon Securities company	CK09
23.	Thang Long Securities company	CK10
<b>Hanoi STC</b>		
1	AIA Insurance company	
2	De Nhat Insurance company	
3	Bao Viet Securities Company	
4	Hai Phong Securities company	
5	ACB Securities company	
6	Incombank Securities Company	
7	Agribank Securities company	
8	Vietcombank Securities company	
9	BIDV Securities company	
10	Sai Gon Securities company	
11	Thang Long Securities company	
12	Ho Chi Minh Securities company	
13	Vietcombank Financial Leasing company	
14	Postal Savings company	
15	Vinashin	
16	Vinatex Finance Company	
17	Manulife Vietnam	
18	Chinfon Bank	

19	Dragon Capital Market Ltd.	
20	BIDV	
21	Incombank	
22	Vietcombank	
23	Vietnam International Bank	
24	Techcombank	
25	Maritime bank	
26	Sacombank	
27	Vietnam Insurance Corporation	

Source: HCMC and Hanoi STCs

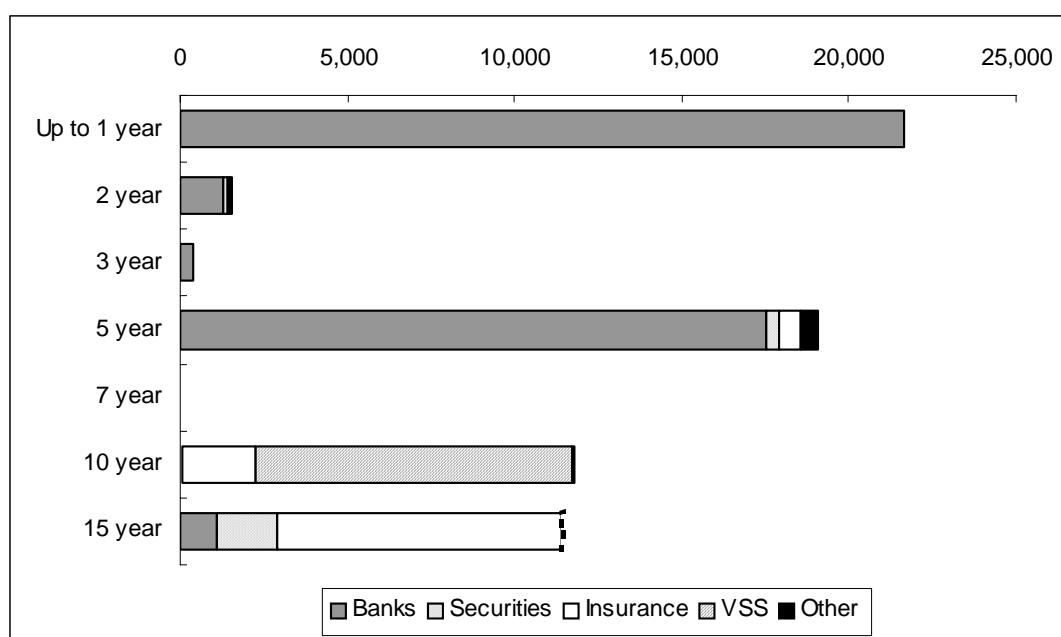
### 1.2.6. Investors

According to Decree 141, the following institutions are entitled to buy Treasury bonds, centrally-run works' bonds and investment bonds. Since these three types of government bonds comprise 70% of the whole outstanding amount, most investors are considered to fall under the following categories.

- Credit organizations
- Insurance companies, insurance funds, investment funds
- Vietnamese enterprises and economic organizations of all economic sectors
- Foreign organizations operating lawfully in Vietnam
- Vietnamese citizens, overseas Vietnamese and individuals being foreigners working and living lawfully in Vietnam

Following chart shows the composition of end-investors for T-bills, Treasury, centrally-run works' and investment bonds issued through auction and underwriting, as well as those "retailed" to VSS<sup>1</sup>. Banks hold most of bonds with tenures of up to 5 years, and life insurers and VSS hold most of 10 and 15 years bonds.

Table & Chart 1-12: Outstanding volume by end-investors (Dec2005/Jan2006)



Note 1: Market value of 2-15 years bonds as of 23 January 2006 (except for outstanding volume of VSS as of yearend 2005); outstanding volume of up to 1 year as of yearend 2005.

Note 2: Data includes only T-bill, treasury, centrally run-works and investment bonds issued through auction and underwriting modes, as well as those "retailed" to VSS.

Unit: Billion VND

Data source: MOF, SBV, HCMC STC and VSS

<sup>1</sup> VSS buys government bonds (in registered form) through retail.

## 1.3. Secondary Market

### 1.3.1. Trading methods

Trading of listed securities is to be conducted through trading members via trading system of HCMC STC<sup>2</sup>. Currently, trading members of HCMC STC are limited to securities companies. Therefore, all transactions of listed bonds are done through the brokerage by securities firms, including inter-bank transactions and buy/sell-backs (repos)<sup>3</sup>.

There are two trading methods applied in HCMC STC: one is order-matching transaction, and the other is negotiable transaction (or put-through method). The latter method was allowed and introduced since August 16, 2004, and has quickly spread as a trading method for bonds, as this method matches the product characteristics of bonds.

In terms of types of transactions at HCMC STC, two types of transactions are considered to exist. The first one is outright, whereby one party sells or buys particular bonds with the other party. The other is repo (in a broad sense), whereby one party sells or buys particular bonds with the other party, with formal or informal agreement to buy back or sell back the same bonds after a particular period of time (including “discount and rediscount” method stipulated by the State Bank). The latter type of transaction (hereinafter referred to as “repo” in a broad sense) has become increasingly popular after the State Bank’s decision to allow credit institutions to “discount and rediscount” valuable papers for clients (Decision No.1325/2004/QD-NHNN).

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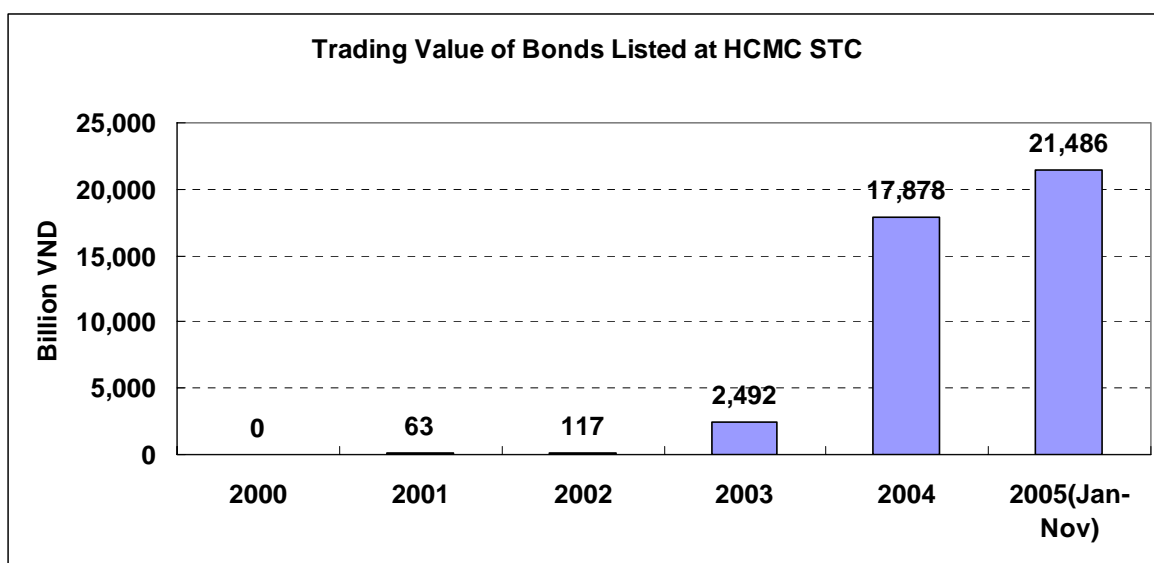
<sup>2</sup> Government bonds, government-guaranteed bonds and local administration bonds are required to be listed at HCMC STC.

<sup>3</sup> Exception is the transactions between the State Bank and credit institutions, whereby credit institutions can trade bonds through the custody accounts of SBV at STC.

### 1.3.2. Trading volumes

Trading of bonds at HCMC STC has seen rapid growth since year 2004 (as shown in the graph below), mainly due to the regulation on discount and rediscount as written above (Decision 1325). Among the total trading value of 21,486 billion VND during January to November 2005, as much as 85 to 90% is considered to be repo, according to NRI's interviews with market players.

Table & Chart 1-13: Trading Value of Bonds Listed at HCMC STC



Note 1: Bonds listed at HCMC STC include government bonds (besides treasury bill), not a few local administrations' bonds, and a few credit institutions' bonds.

Note 2: Trading here means put-through or negotiable transactions.

Data source: HCMC STC

Since most of the transactions are considered to be repo, the purpose of trading at STC is mostly short-term financing. Below table compares STC trading with open market operations (OMO) by the central bank. Market players trade each other through STC more frequently than with SBV, but its value per transaction remains smaller. For banks, bond trading at STC can be deemed to be a supplementary tool to OMO with the State Bank.

Table & Chart 1-14: OMO by SBV vs. Trading through HCMC STC (Jan-Oct/Nov2005)

	Open Market Opr.		HCMC STC
	SBV Buy	SBV Sell	(Put-through)
<b>Value</b>	81,265	1,800	21,486
<b>Number of Transactions</b>	119	8	1,041
<b>Value per Transaction</b>	683	225	21

Unit: Billion VND, except for number of transactions

Note1: Trading activities include both outright and buy/sell-back transactions. Among them, around 80-85% are considered to be the latter (according to NRI's market

interview), and therefore comparable to OMO in terms of their functions for banks.

Note2: Data for OMO is for period between January to October 2005, and data for HCMC STC is from January to November 2005.

Data source: SBV and HCMC STC

### 1.3.3. Intermediaries

Intermediaries in the secondary market are securities companies, who are the trading members of HCMC STC<sup>4</sup>. Below is the list of members as of March 2006.

Table & Chart 1-15: List of members at HCMC STC

No	Name	Full name	Function
1	<a href="#">ACBS</a>	ACB SECURITIES COMPANY Ltd.	Brokerage - Dealing - Underwriting - Portfolio management - Finance and investment consultancy
2	<a href="#">AGRISECO</a>	AGRIBANK SECURITIES COMPANY Ltd.	Brokerage - Dealing - Underwriting - Portfolio management - Finance and investment consultancy
3	<a href="#">BSC</a>	VIETNAM INVESTMENT & DEVELOPMENT BANK SECURITIES COMPANY Ltd.	Brokerage - Dealing - Underwriting - Portfolio management - Finance and investment consultancy
4	<a href="#">BVSC</a>	BAOVIET SECURITIES JOINT STOCK COMPANY	Brokerage - Dealing - Underwriting - Portfolio management - Finance and investment consultancy
5	<a href="#">DAS</a>	EASTERN ASIA BANK SECURITIES COMPANY Ltd.	Brokerage - Dealing - Portfolio management - Finance and investment consultancy
6	<a href="#">FSC</a>	FIRST SECURITIES JOINT STOCK COMPANY	Brokerage - Dealing - Underwriting - Portfolio management - Finance and investment consultancy
7	<a href="#">HASECO</a>	HAIPHONG SECURITIES JOINT STOCK COMPANY	Brokerage - Dealing - Portfolio management - Finance and investment consultancy
8	<a href="#">HSC</a>	HOCHIMINH CITY SECURITIES CORPORATION	Brokerage - Dealing - Underwriting - Portfolio management - Finance and investment consultancy
9	<a href="#">IBS</a>	INCOMBANK SECURITIES COMPANY Ltd.	Brokerage - Dealing - Underwriting - Portfolio management - Finance and investment consultancy
10	<a href="#">MSC</a>	MEKONG SECURITIES CORPORATION	Brokerage - Finance and investment consultancy
11	<a href="#">SSI</a>	SAIGON SECURITIES INCORPORATION	Brokerage - Dealing - Underwriting - Finance and investment consultancy
12	<a href="#">TSC</a>	THANGLONG SECURITIES COMPANY Ltd.	Brokerage - Dealing - Underwriting - Portfolio management - Finance and investment consultancy
13	<a href="#">VCBS</a>	VIETCOMBANK SECURITIES COMPANY Ltd.	Brokerage - Dealing - Underwriting - Portfolio management - Finance and investment consultancy

Source: HCMC STC

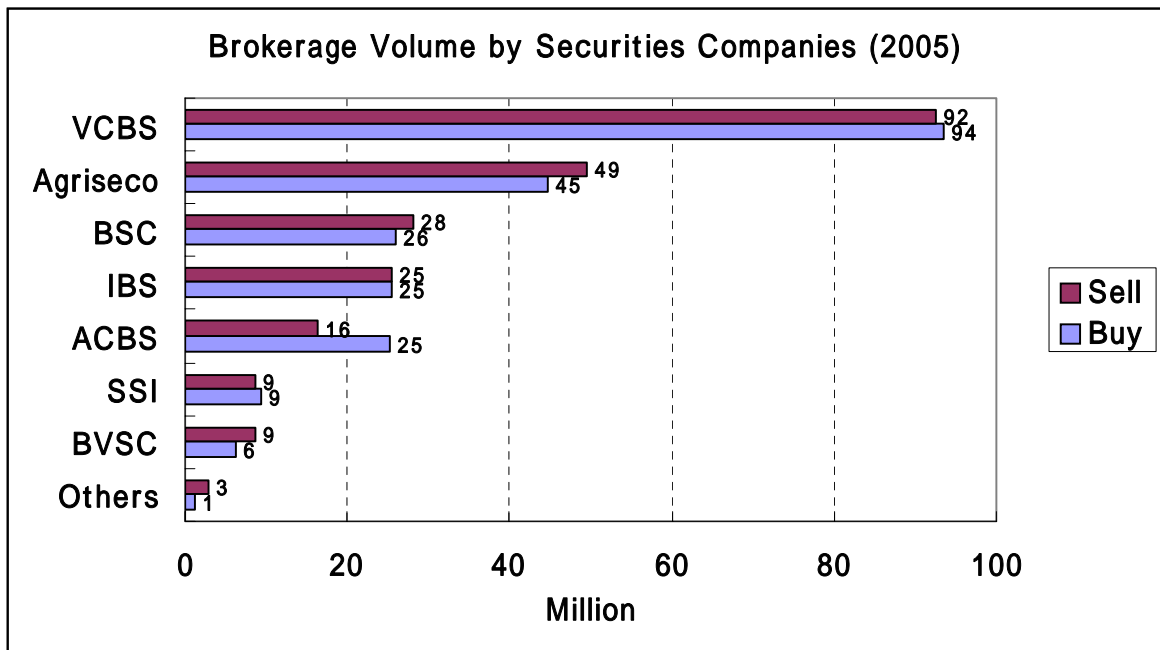
<sup>4</sup> Securities companies that have brokerage and/or self-trading license granted by SSC and have fulfilled member registration procedure at STC are eligible to be members of HCMC STC, according to Decree No.144/2003/ND-CP. They have the distinguished right to trade via trading system of STC.



Securities companies usually executes trades after bilateral negotiations between the transacting parties (clients of securities companies) have been made, and thus this type of intermediation can be described as “brokerage,” rather than dealing.

In terms of brokerage volume, top 2 securities companies share 60% (top 5, more than 90%) in year 2005.

Table & Chart 1-16: Brokerage Volume by Securities Companies (2005)



Note: Data includes bonds (treasury, centrally run-works and investment bonds, almost all) listed at HCMC STC.

Unit: Volume (not market value)

Data source: HCMC STC

## 1.4. Custody, Clearing and Settlement

There are four different routes for government bond issuance as follows.

- 1) Underwriting at State Treasury of MOF and listing at Ho Chi Minh City Securities Trading Center (HOSTC) for Treasury bonds, Centrally-run works bonds and Investment bonds.
- 2) Auction and listing at HOSTC for Treasury bond, Centrally-run works bond and Investment bonds.
- 3) Auction at SBV for Treasury bills.
- 4) Retail at State Treasury's head quarter and its branch offices for Treasury bonds, Centrally-run works bonds and National Construction bonds.

A general plan of the total annual volume of underwriting of government bond issuance is approved at the last session of the annual National Assembly meeting. Based on the approved amount, MOF make up a quarterly and monthly issuance schedules. Treasury department of MOF advise SBV and SSC (STC) of the volume of auction and underwriting on quarterly base within first 10 days at the beginning of quarter. Following are the outlines of administrative operational flows of each issuance process.

### 1.4.1. Underwriting at State Treasury

Settlement operation of underwriting at State Treasury is as follows.

- 1) State Treasury publishes a notice for each government bond issuance upon the authorization by MOF.
- 2) The notice is published from one month to one week at latest before the issuance.
- 3) State Treasury sends the notice to underwriting members who start studying the potential appetite from investors after the receipts of notice.
- 4) Underwriting members submit an application after studying investors' appetites.
- 5) State Treasury holds a meeting for each issuance to discuss on the volume, maturity and so forth with the underwriting members.
- 6) Only the members who are seeking to buy can participate in the meeting.
- 7) State Treasury and the underwriting members enter into a signed agreement.
- 8) The payment for the settlement is usually conducted one or two days after the agreement. The maximum number of days allowed until the payment is five according to the circular.
- 9) The payment is made by remittance to the State Treasury's account opened at the Operating Center at SBV.
- 10) State Treasury sends an official letter by fax followed by mail of the original one to HOSTC for listing, depositing and clearing of the bonds. All the underwritten bonds are listed on HOSTC in a book-entry form.
- 11) Investors are entitled to withdraw the physical certificate of the bond on their request.
- 12) HOSTC deposits the underwritten bonds two or three days after the payment. During the period from the payment to deposit, investors can not deal the

said bonds, because bonds are yet to be posted on their securities account and not available for trading.

- 13) The issuance date is equal to the payment date of the proceeds.
- 14) HOSTC advises State Treasury of the coupon payment date and redemption date, on which State Treasury transfer money accordingly.

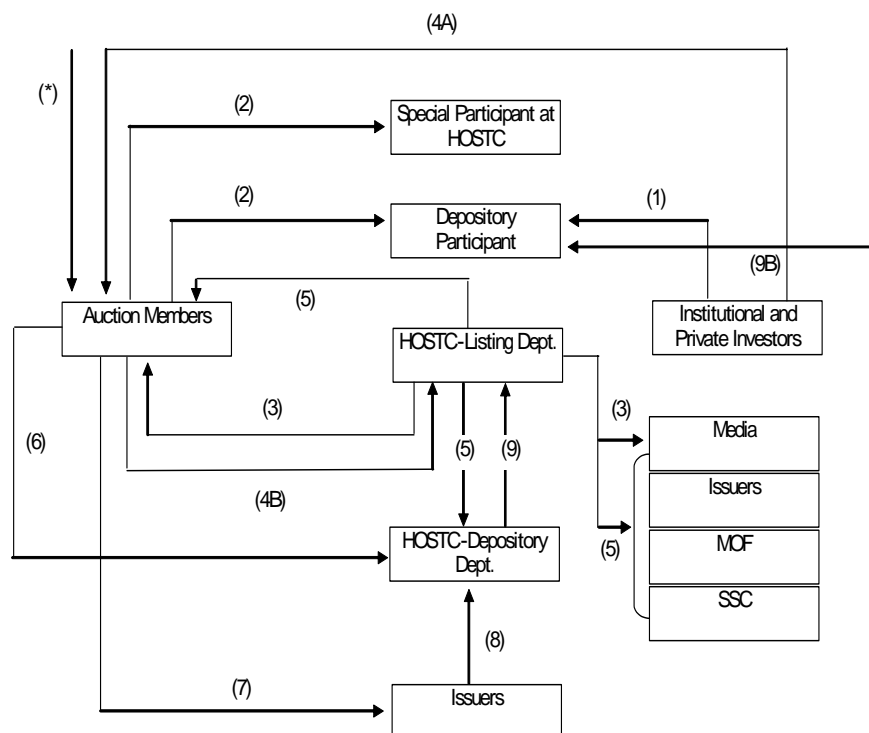
#### **1.4.2. Auction at HCMC STC**

Registration to be an auction member is required periodically once a year at the end of each year. Members apply to HOSTC for the said registration no later than 15th November, while HOSTC informs the member of its approval no later than 15th December. HOSTC confirms within five business days after receiving adequate documents on a requested basis. The 1.4.flow chart shows a chain of operational procedures of auction at STC.

- 1) Institutional and Private Investors who want to take part in one auction have to open a depository account at a depository participant of HOSTC;
- 2) In order to participate in an auction, auction members have to open a depository account directly at HOSTC (in case of special participant) or at a depository member of HOSTC.
- 3) On the fourth business day prior to the auction day, HOSTC informs the auction members of the auction (by fax or by physical delivery of the related document) and the media
- 4) 4A) Institutional and private Investors can place an order through an auction member  
4B) Auction members have to provide Registration Form for auction with the sealed documents and put directly into a box placed on the auction day at HOSTC from 8:00 to 13:00
  - The minimum auction volume is 100.000.000 VND;
  - Each Registration Form accommodate five different auction rates at most;
  - To competitive auction, an auction rate must be described in percentage per annum with the maximum of two decimals:
  - Where no ceiling rate is applied, successful auction volume is determined by those from the lowest rate to the rate, at which accumulated successful bids reach a point of the required issue amount.
  - On the other hand where ceiling rate is applied, successful auction volume is determined from the lowest rate bid to the highest as far as the highest bid rate is within the ceiling rate.
  - In the above two cases, the highest successful bid rate is applied as the issuance rate to all auction members.
  - In case competitive and uncompetitive auction are accommodated at the same time: the uncompetitive auction volume must be equal or lower 30% the total auction volume. The uncompetitive auction members are allowed to buy treasury bonds at the same rate as the competitive auction members do.
  - There are three ways to determine the price and maturity amount: Discount Price, Par Price and Premium Price

- 5) The HOSTC-Listing Department informs the issuer, MOF, SSC and the media of the result of the auction. In addition The Listing Department of STC conveys the result to Depository Department to post into relevant Depository Participants.
- 6) To the auction members who buy bonds for and on behalf of institutional and private Investors, they have to inform the auction details of these parties to The HOSTC-Depository Department no later than 1 day after auction day.
- 7) Within two days after the auction day, auction members transfer the money to the account of the issuer. Issuance day is the second day after the auction day.
- 8) The issuers send the Money transfer List of those who win the auction to The HoSTC-Depository Department. Based on this statement, the Depository Dept. will carry out the depository registration for this bond and post the securities to relevant accounts.
- 9) The HOSTC-Depository Department sends one copy of The Certificate of Depository Registration to The Listing Department. Based on this document together with the Listing Request, The Listing Department carries out the listing procedure for this bond.

Table & Chart 1-17: Workflow of auction at HCMC STC



Source: Author's schematization from HCMC STC interviews

### **1.4.3. Auction at SBV**

Unfortunately NRI team could not have an opportunity to discuss the issues directly with the professionals at SBV who is responsible for the said operation. However, it might fair to mention that the operation at SBV is deemed to be more or less similar to what is done at STC in terms of settlement procedure, namely notice, auction, payment and posting of the securities account. One thing that should be pointed out here is that treasury bills cannot be transferred to depositary members of STC, as there is no securities account in the name of STC opened at SBV. Therefore treasury bills are traded only among banks who are members of SBV.

### **1.4.4. Retail at State Treasury**

Settlement operation of retails at State Treasury is as follow.

- 1) State Treasury breaks down the issuance amount of each issuance channel.
- 2) State Treasury and MOF discuss to make official decisions on interest rate, maturity to be applied to retail sales, but they do not fix expected volume of issuance in advance.
- 3) Individual investors come to State Treasury to pay cash and receive physical securities over the counter of State Treasury's branch offices.
- 4) The payment of proceeds can be made by remittance but most of the investors choose to pay the proceeds by cash mainly because they have to come to State Treasury in person anyway to fill in some documents required to purchase bonds.
- 5) The issuance date is fixed on the date of payment of which money is credited to the account of State Treasury at SBV.
- 6) State Treasury use the system called BMS (Bond Management System) to manage the issuance of the bonds by storing the relevant information. The system started is operation from February 2003 and is used at 600 transaction offices of State Treasury. It works fine so far but needs further enhancement and functional improvement. The currently input data is:
  - Name of a buyer
  - ID card number
  - Buyer's address
  - Issue date and maturity
  - Branch office name at which the bonds are sold.
  - Coupon rate
  - Face value
  - Series number of Certificate
  - Price (but not applicable right now because currently all bonds are issued on par value basis)

Problem that State Treasury is aware of are;

- It cannot manage foreign currency denominated bonds.
- It cannot accept data from STC and SBV.
- It has no linkage to the accounting system of State Treasury.

In order to solve the problem the State Treasury and their designated IT vendor are

entering into an agreement to upgrade functions of the system to complete by the end of year of 2006.

## 2. Challenges for Introducing PD

### 2.1. General Features of PD

#### 2.1.1. Definitions

PD system is widely adopted in many countries and areas (including in ASEAN+3 region, namely in China, Hong Kong, Japan, Malaysia, the Philippines, South Korea, Taiwan and Thailand), and the system has many variants depending on the country's circumstances. Reflecting this diversity, International Monetary Fund (IMF) defines this system in a broad manner, to be “an agreement between two major stakeholders in the domestic government debt market – the debt manager and a group of dealers – to pursue a common strategy in support of the functioning and development of primary and secondary markets for government securities.”

In almost all cases of this system, it can be characterized by a set of obligations and privileges given to qualified PDs to achieve a common goal to function and develop primary and secondary markets for government debt securities. These “common goals” or obligations usually reflect certain issues that each market is uniquely facing (for example, stable absorption under certain circumstances), and PD system is introduced as a solution to such issues.

In this regard, NRI would like to use this term with the following definition: Primary Dealership is a system whereby the government assigns a set of special obligations and privileges to a limited number of market participants (usually dealers), in order to solve specific issues in the bond market<sup>5</sup>, and to offset the risk and cost incurred from the obligations.

#### 2.1.2. Functions

In order to consider introducing the PD system, objectives of the system should be clearly defined. Objectives shall be set in accordance with the challenges of the market. In practice, there are mainly three types of objectives (or expected effects) in introducing PD system, as listed below.



Source: Author's schematization from World Bank documents

<sup>5</sup> The issues are to be determined in line with the priority of debt management objectives.

After the clear definition of objectives in introducing PD system, appropriate design of the system (suitable for objectives) needs to be made in order to make the system workable. In this design process, three basic components of PD system – obligations and privileges, membership and target securities & transactions – should be determined, in accordance with the objective.

## 2.2. Vietnamese Context of PD

### 2.2.1. Objective of examining PD

Through discussions with MOF, the NRI study team has identified in general the reasons why MOF may want to examine PD system in Vietnam as follows:

- Primary market: Both auction members and underwriters are not necessarily obligated to bid, subscribe and underwrite a certain proportion of any type of government bonds.
- Secondary market: Secondary market remains underdeveloped so far, most likely leading to lesser popularity of government bonds and hence to higher issuance cost of it.

### 2.2.2. Expected functions of PD

Through discussions with MOF, the NRI study team has also identified in general possible functions of PD system in Vietnam, which MOF may want to see as follows:

- Primary market: PDs shall be obligated to subscribe for a certain proportion of government bonds, and instead be given exclusive rights for subscription.
- Secondary market: PDs shall be obligated to make market to some extent.

### 2.2.3. Pros and cons of PD

Possible advantage of PD in Vietnam shall include:

- Stabilities of absorption and interest rate movement: Stability of issuance will help smoothing the demand of bidders per auction, which will also help stabilizing price.
- Development of benchmark bonds: Through competitive pricing and active dealing, 5 year bonds are expected to function as the initial benchmark bonds.
- Enhancement of price discovery: There will be increase in the number of bidders in the primary market, and thus pricing would be more driven by competition. Pricing and trading practices will be established and widely used, which creates more transparency and thus participation by wider participants in the secondary market.

On the other hand, possible disadvantage shall include:

- Hike of issuance cost: Relaxation or abolishment of interest rate ceiling shall prevail the market rate, which is not necessarily always lower than the ceiling.



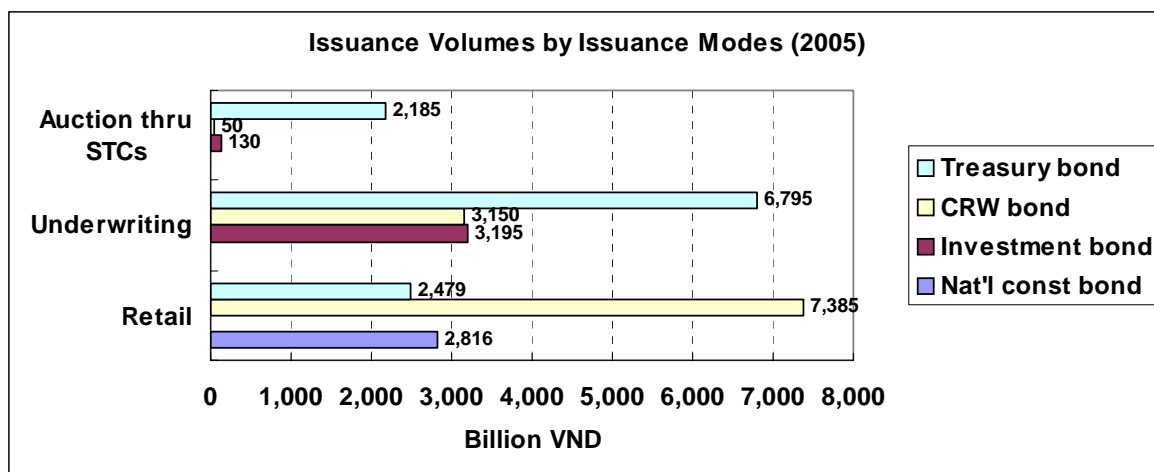
## 2.3. Challenges for Introducing PD in Vietnam

### 2.3.1. Issuance modes

One of the essential features of PD system is price discovery, and PD systems in many countries usually adopt competitive auction for better price discovery in the primary market. For this to work well, issuance modes (channels) need to be properly managed so as not to discourage PDs to perform competitively in auctions. For example, if there are any other attractive channels, PDs would lose the incentive to be competitive in auctions.

In Vietnam, however, there are currently signs that auction participants do not have incentives to perform competitively in auctions. Most of the Treasury and centrally-run works' bonds are issued via underwriting and retail channels (accounting for 81% and 99.5% respectively), and auctions only comprise a small portion. Similarly, most investment bonds are issued via underwriting (96%), rather than auctions. This shows that underwriting and retail channels outweigh, or crowd-out, auction at STCs.

Table & Chart 2-2: Issuance volumes by issuance modes (2005)



Note: Government bonds here excludes treasury bill and foreign currency bond which are auctioned at SBV.

Data source: MOF

The dominance of underwriting is explained by the easiness of this mode, both for the issuing and underwriting organizations. According to NRI's interviews with market participants, underwriting can flexibly take place upon request by the underwriting organizations. Also, this issuance mode leaves flexibility on other terms and conditions as well (e.g. issue amount, tenure and others), since these are determined by bilateral negotiations between issuing and underwriting organizations.

This discourages bidding members of STC to participate in auctions, resulting in average number of successful bidders in each auction accounting for only 1.72 for Treasury and centrally-run works' bonds, and 0.4 for investment bonds.

Table & Chart 2-3: Auction vs. underwriting results (2005)

	T- and CRW-Bonds		Investment Bonds		T-bills
	Auction	Underwriting	Auction	Underwriting	Auction
Average # of participants	--	2.07	--	1	2.4
Average # of successful bidders	1.72	--	0.4	--	2.1
# of Auction / Underwriting	25	55	10	28	60
Average issue amount	89	181	8	105	369
Tenures	5 yrs	2, 3, 5, 10, 15 yrs	10, 15 yrs	2, 10, 15 yrs	182, 273, 364 days

Unit: Billion VND

Data source: MOF and SBV

Not only underwriting, but also retail channel is crowding out auctions, as the issue amount through this channel is much larger than auctions. Organizations as well as individuals are allowed to purchase government bonds in both register and non-register forms through retail<sup>6</sup>.

Table & Chart 2-4: Eligible buyers and types of bonds issued via retail (2005)

	Buyers	Types of bonds
Registered bond	➤ Individuals ➤ Organizations	➤ Treasury bonds ➤ Centrally-run works' bonds <sup>7</sup>
Non-registered bond	➤ Individuals ➤ Organizations	➤ National construction bonds ➤ Centrally-run works' bonds

Source) Based on NRI's interviews

### 2.3.2. Issuance schedules

According to regulations explained below, government bond issuance schedules are to be announced both at the beginning of fiscal year and before the issuance.

Decision 66 stipulates requirement for disclosure of government bond issuance plans. According to this Decision, the State Treasury and the Development Assistance Fund (for investment bonds) are to "publicly disclose information on the approved bond issuance plans or annual reports specified by months according to each type of bond, bond term and issuance mode."

Also, under Circular 21, bidding shall be organized weekly, monthly or quarterly, and STCs should announce the following information four working days before the bidding:

- Volume of to-b-issued bonds
- Bidding date

<sup>6</sup> Therefore, it is impossible to assess the amount held by institutions if they purchase non-register bonds.

<sup>7</sup> Underwriting and bidding organizations were not allowed to purchase centrally-run works' bonds through the retail channels in 2005 (Decision No. 9), and in 2006, this type of bonds will not be issued through the retail channel.

- Bidding form
- Issuance date
- Maturity date
- Forms of bond
- Forms of bond sale
- Modes of principal and interest payment

For underwriting and issuance agents, notification should be made at least 20 days before the issuance date.

However, for both, schedule seems not to be predetermined and disclosed in advance. For auctions at STC in 2005, although monthly auction plans were developed at the beginning of year, the plan was not executed except for the first month (January)<sup>8</sup>. There have also been complaints from market players about unclear issuance plan.

Considering that underwriting is flexibly conducted without any yearly or quarterly schedule (it is conducted “upon-request” basis), unclear issuance schedule may only make auctions less attractive compared to underwriting.

Table & Chart 2-5: T- and CRW-bonds Auctions (2005)

Issuance Date	Issue Amount	Tenure	# of Successful Bidders
1/26	50	5	1
2/24	115	5	3
3/15	0	5	1
3/30	190	5	3
4/14	200	5	3
4/28	0	5	1
5/12	0	5	1
5/31	30	5	1
6/14	200	5	4
6/20	70	5	2
6/24	150	5	2
7/11	70	5	2
7/20	0	5	1
8/12	20	5	1
8/23	100	5	1
9/5	50	5	1
9/13	100	5	1
9/22	120	5	3
9/28	100	5	1
10/1	20	5	1
10/25	50	5	2
11/4	200	5	2
11/17	200	5	2
11/30	50	5	1
12/13	150	5	2
<b>Average</b>	<b>89</b>		<b>1.72</b>

Data source: MOF

<sup>8</sup> According to NRI's interviews.

Table & Chart 2-6: T- and CRW-bonds Underwritings (2005)

Sales Date	Issue Amount	Tenure	# of Participants	Sales Date	Issue Amount	Tenure	# of Participants
1/14	103	5	2	8/25	50	15	1
1/31	20	5	1	9/13	130	5	2
2/28	220	5	3	9/15	200	5	1
3/7	780	5	3	9/28	770	5	4
3/10	50	5	1	10/20	370	5	4
3/22	320	5	3	10/20	15	2	1
4/6	440	5	4	10/20	15	3	1
4/13	50	10	1	10/24	100	5	1
4/20	300	5	4	10/28	100	5	1
5/6	180	5	3	11/3	150	5	3
5/17	105	15	1	11/3	50	2	1
5/20	120	5	2	11/8	200	5	1
5/27	65	5	1	11/8	150	2	1
6/6	70	5	2	11/11	188	5	2
6/10	250	5	2	11/11	80	2	1
6/15	100	15	1	11/15	100	5	1
6/17	60	5	2	11/24	165	5	5
6/30	170	5	1	11/24	81	2	1
6/30	90	15	1	11/24	150	3	2
7/7	320	5	5	11/30	125	5	2
7/22	50	5	2	12/5	240	5	1
7/22	50	2	1	12/8	270	10	1
7/22	20	3	1	12/8	200	5	4
7/28	158	5	1	12/8	80	2	2
8/8	480	5	5	12/8	90	3	2
8/9	380	5	4	12/22	80	2	2
8/9	50	15	1	12/22	515	5	4
8/25	280	5	4	<b>Average</b>	<b>181</b>		<b>2.07</b>

Data source: MOF

Table & Chart 2-7: Investment Bond Auctions (2005)

Issuance Date	Issue Amount	Tenure	# of Successful Bidders
3/31	75	15	4
5/13	0	10	0
5/13	0	15	0
5/20	0	10	0
5/20	0	15	0
7/15	0	10	0
7/15	0	15	0
7/29	0	10	0
7/29	0	15	0
8/24	0	15	0
<b>Average</b>	<b>8</b>		<b>0.40</b>

Note: For "issuance date" of the 8th auction of investment bond, date of auction is applied, as the issuance date was unknown from the data.

Data source: MOF

Table & Chart 2-8: Investment Bond Underwritings (2005)

Sales Date	Issue Amount	Tenure	# of Participants
1/25	40	10	1
1/31	100	10	1
1/31	100	15	1
3/31	50	15	1
4/5	80	2	1
4/8	75	2	1
4/21	50	10	1
4/26	200	10	1
4/28	150	15	1
5/25	50	10	1
5/25	80	15	1
5/30	205	10	1
6/21	90	15	1
6/30	10	2	1
7/12	80	10	1
7/29	10	2	1
8/11	10	2	1
8/16	100	10	1
8/24	120	10	1
9/20	80	10	1
10/5	30	2	1
10/21	80	15	1
11/18	140	15	1
12/15	15	2	1
12/20	200	15	1
12/21	200	15	1
12/23	100	15	1
12/26	500	15	1
<b>Average</b>	<b>105</b>		<b>1.00</b>

Unit: Billion VND

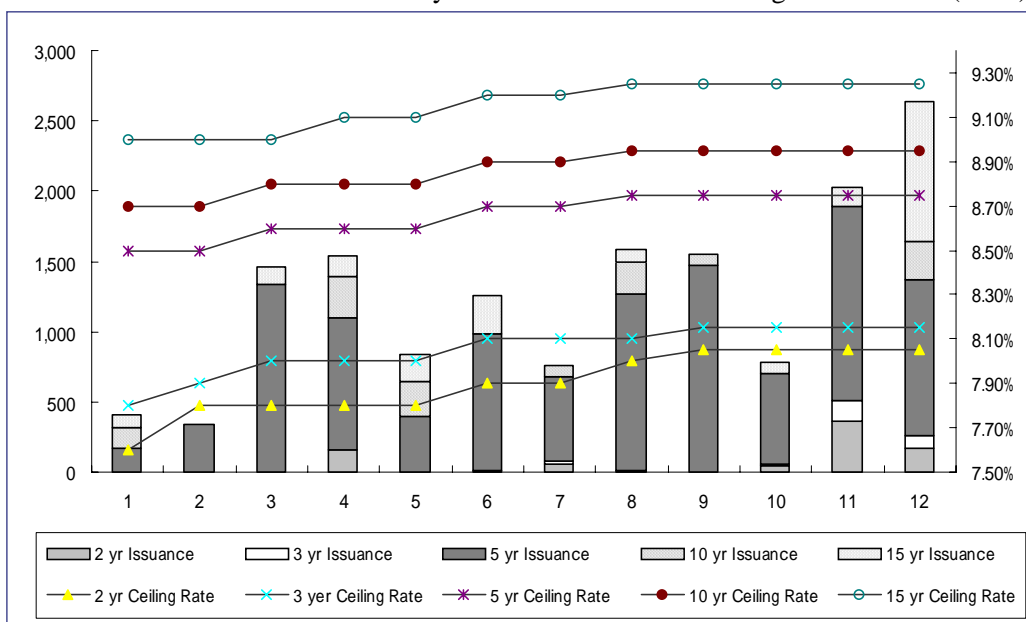
Sales date: Auction date for auction, and issuance date for underwriting.

Data source: MOF

In general, clear issuance schedule is important for bidders to get prepared for auctions. Especially, in PD system, such plan is essential for the risk management of PDs, since they are usually required to bid and/or take certain portion of issue amount. Therefore, disclosure of issuance plan is one of the prerequisites to introduce PD system.

Issuance plan is also important for the issuer, because without stable plans the issuer tends to be vulnerable to interest rate changes. For example, during 2005, interest rate was on the rise continuously. However, 36% of issuance (through auction and underwriting) was conducted in the fourth quarter, when the interest rate was at the highest. This has led to higher issuance cost than if it had been issued with stable schedule.

Table & Chart 2-9: Monthly issuance volume and ceiling interest rates (2005)



Note: Data includes only treasury, centrally run-works and investment bonds issued through auction and underwriting modes.

Unit: Billion VND

Data source: MOF and VCBS

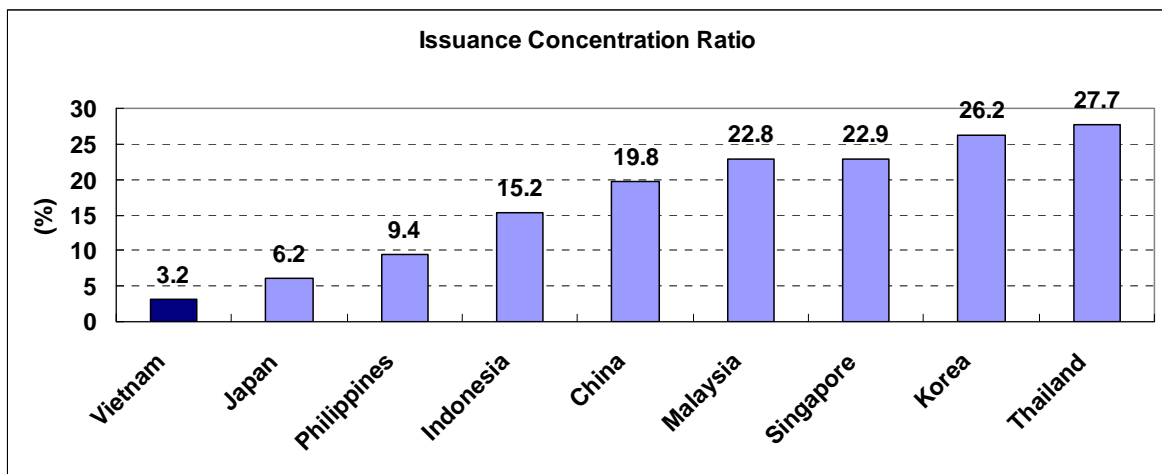
### 2.3.3. Issue size

To keep sufficient issue size per each bond series is an important factor to enable price discovery efficiently. In order to develop a reliable benchmark yield curve, issue size per series needs to be large enough for various market players to price and make transactions. With smaller issue size, bonds will be absorbed by a few players, making it difficult for others to make market, and also making it easier to manipulate (e.g. front-running and squeezing).

In comparison with selected ASEAN+3 countries, Vietnam has the most scattered numbers of government bonds. This means that issue size is very small per each issuance, making it very difficult to trade these bonds. This is because government bonds are subdivided into many product types and issuance modes, and in addition, among each mode, issuance was conducted very frequently, totaling up to 118 times of auctions and underwriting during 2005 (number of retail sessions is not known).

This issue should be addressed along with the design of obligations or privileges of PDs. For example, if PDs are required to trade in the secondary market, small issue size will be a big bottleneck. Also, if PDs have the privilege to participate exclusively in auctions, the risk of market manipulation increases (squeeze or cornering happens if issue size is small enough for one PD to buy up all and control the price), which needs to be avoided by managing the issue size or the design of privileges.

Table & Chart 2-10: Issuance concentration ratio in select ASEAN+3



Note 1: Issuance concentration ratio = Total outstanding of the three largest government bond issues / Outstanding government bond volume

Note 2: Data varies from 2004 to 2005 depending on country.

Data source: "Asia Bond Indicators," ADB Asian Bonds Online

### 2.3.4. Ceiling interest rates

As described earlier, ceiling interest rates of government bonds are tightly set, and are not necessarily consistent with market interest rates.

Table & Chart 2-11: Ceiling interest rates vs. market rates (Dec 2005)

Term	Ceiling interest rates	Bank deposit rates		VNIBOR
		Individual	Corporate	
1 month		6.24%	6.96%	
3 month		7.44%	7.56%	around 7.90% - 8.00%
6 month		7.80%	7.80%	around 8.20% - 8.25%
1 year	6.30%	8.40%	8.40%	
2 year	8.05%	9.00%	9.00%	
3 year	8.15%	9.12%	9.12%	
5 year	8.75%	9.36%	9.36%	
10 year	8.95%			
15 year	9.25%			

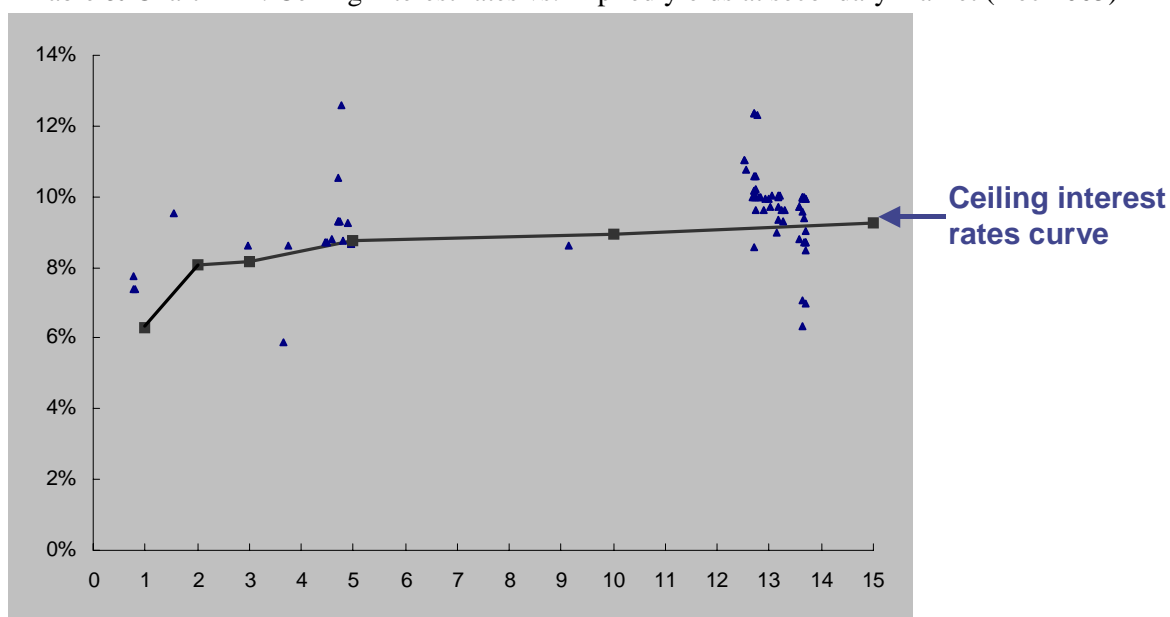
Note 1: as of December 2005

Note 2: Bank deposit rates of VCB's Hanoi capital region

Data source: MOF, VCB and VCBS

Also, ceiling interest rates are mostly lower than the market rates of government bonds traded at secondary market, as shown in the below graph.

Table & Chart 2-12: Ceiling interest rates vs. implied yields at secondary market (Dec 2005)



Note: Implied yields of treasury, centrally-run works and investment bonds listed at HCMC STC.

Data source: VCBS

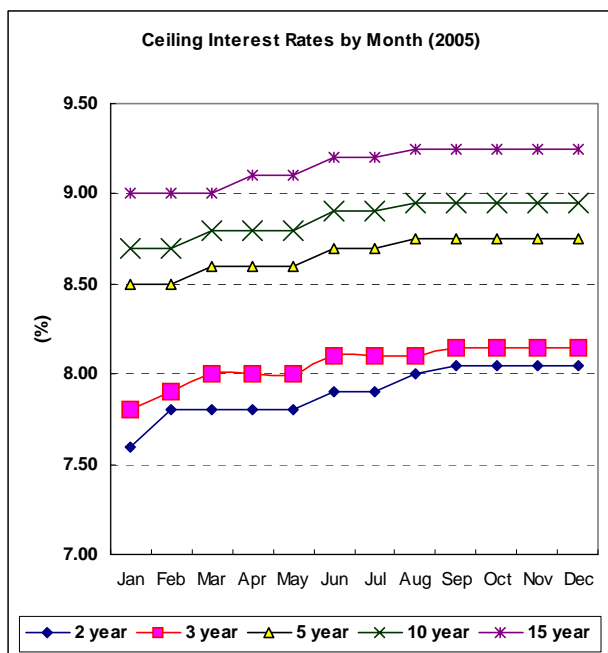


As almost all the government bonds, except for T-bills, are issued at par, ceiling interest rates effectively cap prices at the primary market. MOF sets out the ceiling interest rates as a response to the absence of competition in auctions (only a very few bidders participate per auction on average). However, this measure leaves auction participants very limited room for bargaining, or just let them opt for not participating at all, which again leads to lesser competition. This kind of vicious circle is observed in the primary market.

Also, the existence of tight ceiling interest rates distorts the holding patterns of market players, thus makes it difficult to observe the real market demands and movements. During 2005, as shown in the ceiling rate graph below, there was a wide gap between 3 year ceiling rate and 5 year ceiling rate. This has presumably distorted the tenure preference of banks, making them opt for 5 years rather than 2 or 3 years (see graph below; banks usually hold larger portion in 2 or 3 year bonds in order to match asset and liability, but not so in this case)<sup>9</sup>.

Relax of ceiling interest rate should be addressed along with the introduction of PD system, because PDs are primarily required to discover market prices, both in the primary and secondary markets, through competitive auctions.

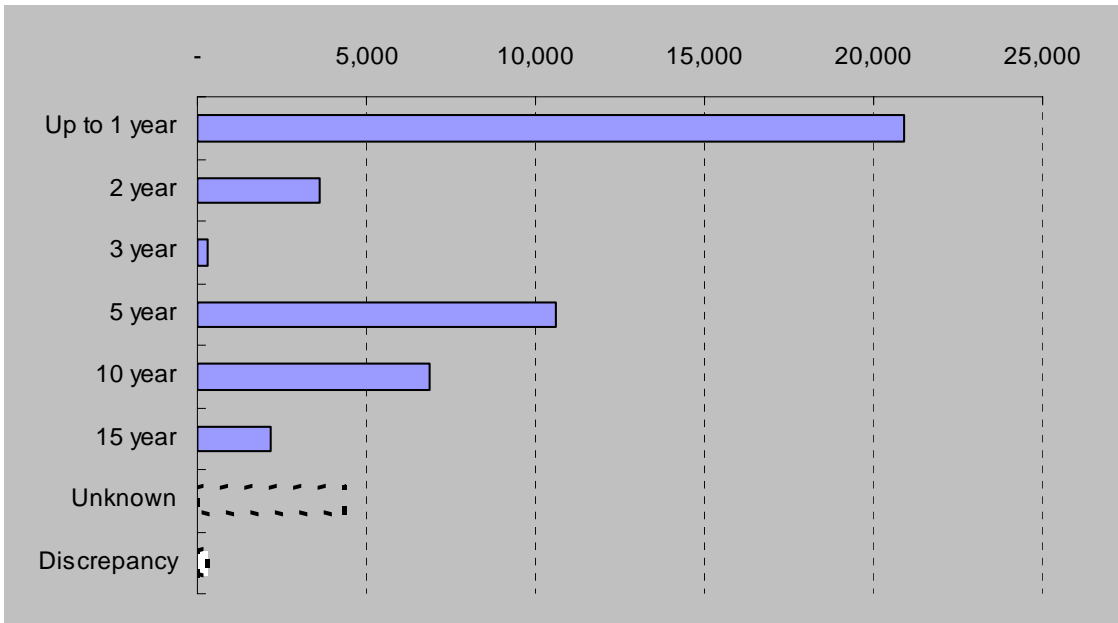
Table & Chart 2-13: Ceiling Interest Rates by Months (2005)



Data source: VCBS

<sup>9</sup> In practice tenures are predominantly determined upon request by underwriters and/or end-investors in case of underwritings, rather than the issuance plan of the State Treasury.

Table & Chart 2-14: Annual Issuance Volume by Tenure (2005)



Unit: Billion VND

Data source: MOF

### 2.3.5. Investor base

Without diverse investor base, trading in the secondary market would not be activated, since without such diversity, it becomes difficult to find trading counterparties in the secondary market. Therefore, diverse investor base is also one of the prerequisites to PD system, if any of the secondary market obligations are to be adopted.

In Vietnam, there are signs that investor base for government bonds are very limited. T-bills are mostly purchased by 4 SOCBs, with nearly 100% share. For 2-5 year bonds, 4 SOCBs and its securities companies bought and/or intermediated nearly 80%. Similarly, top 1 securities company purchased nearly 80% of 10 year bonds, and top 3 securities companies purchased more than 90% of 15 year bonds. This presumably means that (a) 2, 3 and 5 year bonds are mostly held by 4 SOCBs, and (b) 10 and 15 year bonds are mostly held by 2 or 3 insurers. Therefore, in any tenure, there are only 2 to 4 large investors in the market.

Table & Chart 2-15: Successful bidders and underwriters by tenures (2005)

	VCB Group		ICB Group		BIDV Group		AGRIBANK Gr.		ACBS	BVSC	T.LONGSC	MHB	OHTERS	Total
	VCB	VCBS	ICB	ICBS	BIDV	BSC	AGRIBANK	AGRISECO						
Up to	7,497	0	3,485	0	3,491	0	7,076	0	0	0	0	0	122	21,671
1 year	35%	0%	16%	0%	16%	0%	33%	0%	0%	0%	0%	0%	1%	100%
2 year	151	525	110	30	0	0	0	0	0	0	0	0	0	816
	19%	64%	13%	4%	0%	0%	0%	0%	0%	0%	0%	0%	0%	100%
3 year	140	15	70	0	0	0	0	0	50	0	0	0	0	275
	51%	5%	25%	0%	0%	0%	0%	0%	18%	0%	0%	0%	0%	100%
5 year	940	2,264	2,087	0	320	1,830	0	750	1,226	0	330	661	197	10,604
	9%	21%	20%	0%	3%	17%	0%	7%	12%	0%	3%	6%	2%	100%
10 year	0	270	0	0	0	0	0	50	0	1,025	0	0	0	1,345
	0%	20%	0%	0%	0%	0%	0%	4%	0%	76%	0%	0%	0%	100%
15 year	0	465	0	90	0	0	0	900	0	645	0	0	60	2,160
	0%	22%	0%	4%	0%	0%	0%	42%	0%	30%	0%	0%	3%	100%
Total	8,728	3,539	5,751	120	3,811	1,830	7,076	1,700	1,276	1,670	330	661	379	36,871
	24%	10%	16%	0%	10%	5%	19%	5%	3%	5%	1%	2%	1%	100%

Note: Data includes only treasury, centrally run-works and investment bonds issued through auction and underwriting modes.

Unit: Billion VND

Data source: MOF and SBV

### 2.3.6. Trading intermediary

Although years 2004 and 2005 have seen massive increase in the secondary market trading, the number of transactions is still very few. Number of transaction per working day averages approximately 4 only, making market-making almost impossible. Although one bank has recently announced to become a market maker (to quote indicative price, rather than firm price), there still exists very limited practice of it as a whole, impeding the liquidity of government bonds.

This is partly because the number of intermediaries itself is limited. Large portion of secondary market transactions are conducted by only a few large players, and led by the two largest (VCBS and Agriseco). Again, existence of enough trading intermediaries is a prerequisite to PD system, if any of the secondary market obligations are to be adopted.

Table & Chart 2-16: Number of Secondary Market “Put Through” Trading in 2005

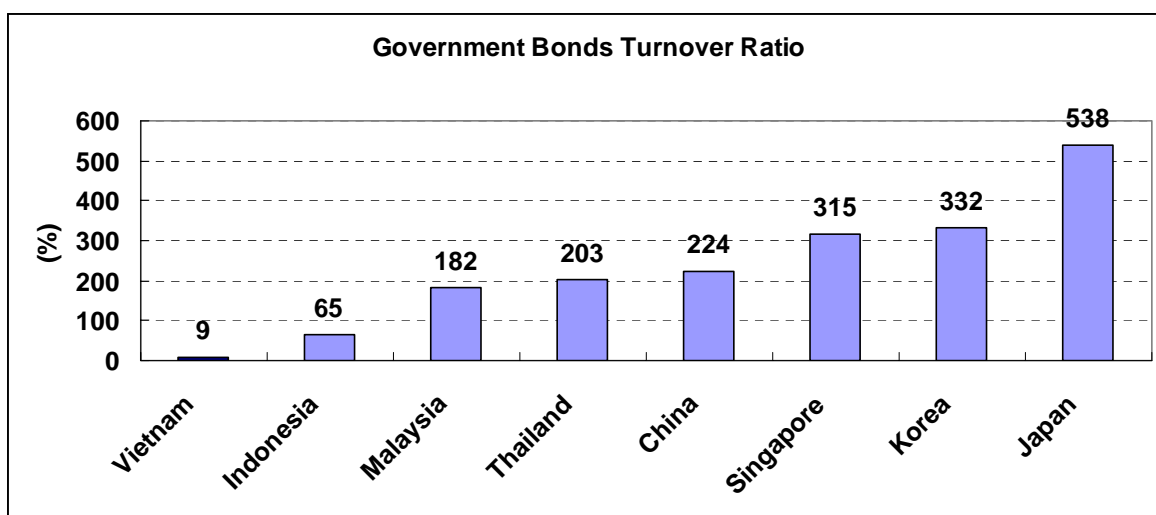
	BVSC		BSC		SSI		FSC		TSC		ACBS		IBS		AGRISECO		VCBS		MSC		HSC		HASECO		DAS		Total	
	Buy	Sell	Buy	Sell	Buy	Sell	Buy	Sell	Buy	Sell	Buy	Sell	Buy	Sell	Buy	Sell	Buy	Sell	Buy	Sell	Buy	Sell	Buy	Sell	Buy	Sell	Buy	Sell
2005/1	3	2	5	3	3	3	0	0	0	0	2	2	8	5	13	17	19	19	0	0	0	1	0	0	1	2	54	54
2005/2	2	1	5	4	3	4	0	0	0	0	0	0	1	1	13	16	10	8	0	0	0	0	0	0	0	0	34	34
2005/3	7	2	10	8	6	4	0	0	0	0	0	3	6	8	26	25	16	19	0	0	0	0	0	1	0	1	71	71
2005/4	2	4	13	10	4	6	0	0	0	0	5	2	3	3	33	35	22	14	0	0	0	0	0	0	1	9	83	83
2005/5	1	5	11	8	4	2	0	0	0	0	1	0	2	2	27	32	18	13	0	0	0	1	0	0	0	1	64	64
2005/6	7	7	7	5	8	5	0	0	0	0	6	2	4	5	25	36	34	30	0	0	0	0	0	1	0	0	91	91
2005/7	12	11	6	18	0	4	0	0	0	0	3	2	5	4	44	40	35	32	0	0	2	0	0	0	7	3	114	114
2005/8	10	9	5	3	4	4	0	1	0	0	2	7	4	23	38	36	26	0	0	0	0	0	0	0	2	0	87	87
2005/9	7	8	10	6	2	5	0	0	0	0	2	8	13	9	37	43	47	40	0	0	0	0	0	1	2	0	120	120
2005/10	3	4	12	17	5	5	0	0	0	0	24	16	8	14	43	44	42	34	0	0	0	1	0	2	0	0	137	137
2005/11	3	4	9	11	6	6	0	0	1	0	3	1	11	10	50	38	20	31	0	0	1	0	0	1	0	2	104	104
2005/12	6	7	10	13	4	7	0	0	1	0	3	2	13	12	12	11	31	23	0	0	0	4	2	1	0	2	82	82
<b>Total</b>	<b>63</b>	<b>64</b>	<b>103</b>	<b>106</b>	<b>49</b>	<b>55</b>	<b>0</b>	<b>1</b>	<b>2</b>	<b>0</b>	<b>49</b>	<b>40</b>	<b>81</b>	<b>77</b>	<b>346</b>	<b>375</b>	<b>330</b>	<b>289</b>	<b>0</b>	<b>0</b>	<b>3</b>	<b>7</b>	<b>2</b>	<b>7</b>	<b>13</b>	<b>20</b>	<b>1,041</b>	<b>1,041</b>
(%)	6%	6%	10%	10%	5%	5%	0%	0%	0%	0%	5%	4%	8%	7%	33%	36%	32%	28%	0%	0%	0%	1%	0%	1%	1%	2%	100%	100%

Unit: Number of Transactions

Data source: HCMC STC

Reflecting such situations, Vietnam’s government bonds turnover ratio remains the lowest among select ASEAN+3 countries.

Table & Chart 2-17: Government bonds turnover ratio



Note 1: Turnover ratio = Annual trading value (excl. repo) / Annual average outstanding  
 Note 2: Vietnam as of 2005; other countries as of 2004

Data source: NRI’s rough estimate for Vietnam; “Asia Bond Indicators,” ADB Asian Bonds Online for other countries

### 2.3.7. Price information

Reliable and timely price information is indispensable for dealers to make market, and for investors to activate buy and sell in the secondary market. Also, price information will be the basis for mark-to-market requirements (which are required but not implemented in Vietnam), and without this, international-standard repo cannot be implemented either.

Currently, although STC collects and disseminates such price information, there is no distinction between outright and repo (i.e. securities companies are not required to report them separately). Since only short-term interest rates are relevant to repo, pricing of underlying bonds itself tends to be rough rather than accurate. Therefore, it is difficult to assess the real market value of a particular bond through the trading data.

### **2.3.8. Custody, clearing and settlement**

Findings and observations on custody, clearing and settlement are as follows:

- 1) Issuance routes are scattered at four places resulting in difficulty to integrate information at one point of place with regards to government bond issuance.
- 2) Consequently relevant depository and settlement functions are also split to each organization.
- 3) Following is an example of risk incurred from the split of the settlement function:
  - From investor's view point there is a timing gap for a few days between payment of proceeds at State Treasury and the receipt of the new purchased securities at STC.
  - Such gap comes from the fact that it takes a few days for State Treasury to deliver the relevant investors list to STC, which is the official supporting evidence for STC to post securities to investors account.
  - The gap could put investors in a risky position that they cannot sell the purchased bonds until the time of booking of the bonds to their securities account at STC, even just for a few days.

Recommendations for further improvement of custody, clearing and settlement operation are as follows.

- 1) To organize a committee under initiative of MOF in order to discuss integration on management information with regard to government bond issuance consisting of relevant departments of the governmental organizations such as MOF, ST, SBV, STC and other relevant and competent organization.
- 2) Focal points of discussion are;
  - How can good quality of management information on the issuance of government bonds be available in a timely manner with accuracy?
  - What kind of resources is required to make the above? Is it human resources and / or information technology?
  - How can they find various risks built in the settlement infrastructure and find ways to mitigate such risks?
  - What is positioning of this infrastructural issue in relation to designing strategy of government bond market development?

## 2.4. Prerequisites and addressability of PD

As described above, a number of prerequisites need to be cleared beforehand for PD to function effectively in Vietnam, while PD can also address several challenges thereafter.

Table & Chart 2-18: Prerequisites and addressability of PD

Challenges	Prerequisite to PD	Addressable by PD	Neutral to PD
2.3.1 Issuance mode	Yes		
2.3.2 Issuance schedule	Yes		
2.3.3. Issue size		Yes	
2.3.4. Ceiling interest rate		Yes	
2.3.5. Investor base	Yes		
2.3.6. Trading intermediary	(Yes)		
2.3.7. Price information	(Yes)		
2.3.8. Custody, Clearing & Settlement			Yes

Note: “Yes” with parenthesis “(Yes)” means Yes provided that the PD system is with secondary market obligations.

Source: Author’s schematization

### 3. Necessary Reforms for PD to Work

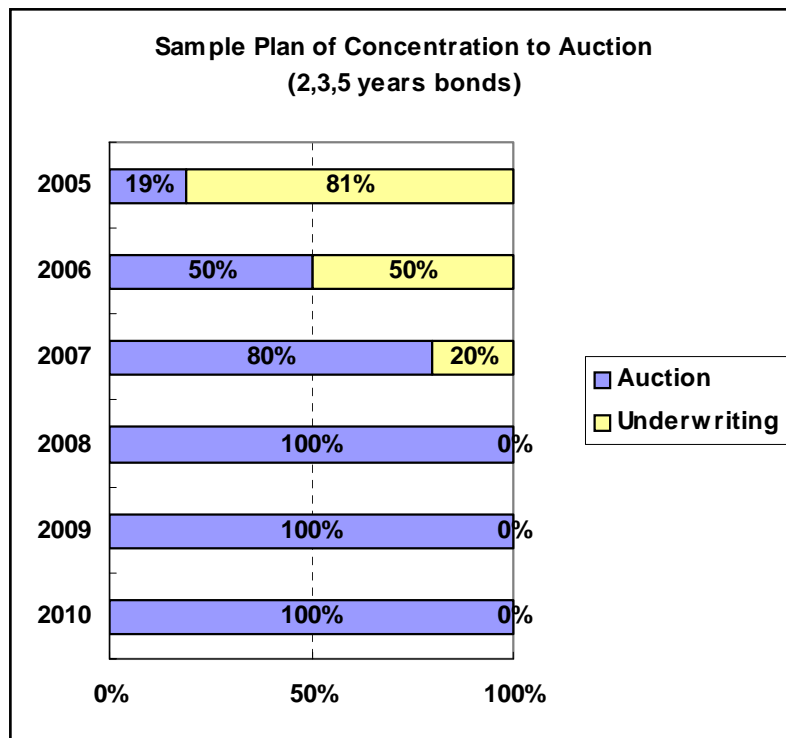
#### 3.1. Reform of the Primary Market

##### 3.1.1. Concentrate 2,3,5 years bonds to auction

5-year bonds have most variety of successful bidders and underwriters, as shown in table in 2.3.5. There are seven bidders and underwriters who subscribe for at least five percents of treasury, centrally run-works and investment bonds issued through auction and underwriting modes. It may be safe to assume that similar variety shall apply to 2- to 3- year bonds, provided the distortion by ceiling interest rates be minimized or wiped out.

Therefore MOF is suggested to concentrate 2-, 3- and 5-year bonds to auction only, by gradually shifting issuance mode from underwriting within a few forthcoming years.

Table & Chart 3-1: Example plan of shifting from underwriting to auction



Data source: MOF for 2005; NRI's example schematization for 2006-2010

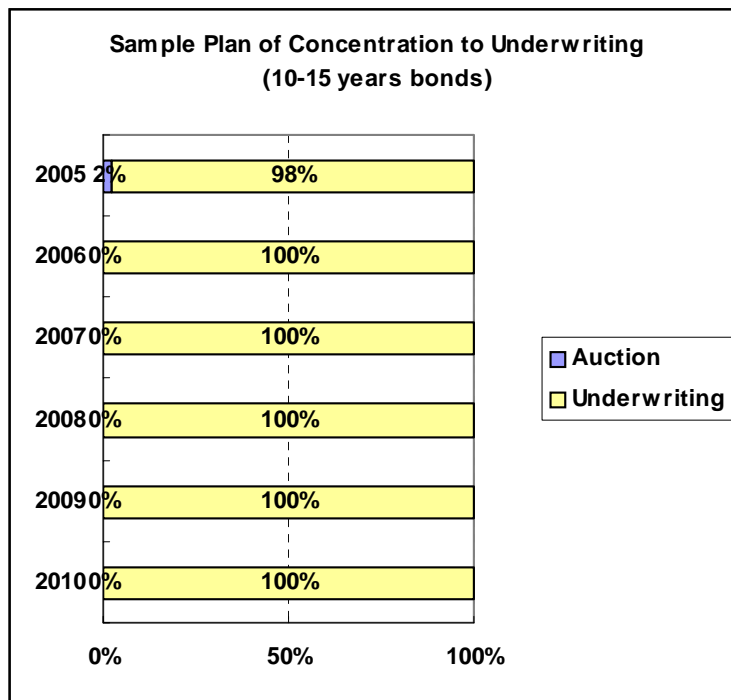


### 3.1.2. Concentrate 10-15 years bonds to underwriting

10- and 15-year bonds have only a few successful bidders, underwriters, and hence end-investors, as shown in table in 2.3.4. and 2.3.5. This limited variety, in particular of end-investors, implies that 10- and 15-year bonds are not necessarily good for auctions at current, as auctions may not become competitive by nature.

Therefore MOF is suggested to concentrate 10- and 15-year bonds to underwriting only<sup>10</sup>, simply by suspending the issuance mode of auction, which is even at current unpopular and under-subscribed.

Table & Chart 3-2: Example plan of concentration to underwriting



Data source: MOF for 2005; NRI's example schematization for 2006-2010

<sup>10</sup> Should the number of end-investors, who are most likely newly licensed life insurers and VSS, increase to a reasonable level, then MOF may want to and be able to resume auctions.

### 3.1.3. Announce annual issuance plan

At current MOF announces issuance volume of only a few types of government bonds, namely centrally-run works bonds and national construction bonds, for a particular year in an ad-hoc manner, but even such an announcement doesn't detail by tenure. This originates from the fact that MOF annually predicts issuance volume by type but by tenure. If an annual issuance plan not only by type but also by tenure becomes available, it will be highly appreciated by intermediaries and investors who are distinctively different between 2,3,5 years bonds and 10-15 years ones.

Therefore MOF is suggested to elaborate and announce, from the earliest possible near future, annual issuance plans of government bonds as a whole, by type and by issuance mode.

Table & Chart 3-3: Example of annual issuance plan (2008)

		Auction thru SBV	Auction thru STCs	Underwriting	Retail	Total
1 Treasury bill	up to 1 year	20,800				20,800
2 Treasury bond	2 year		4,800			4,800
3 Centrally-run works bond	3 year		4,800			4,800
	5 year		4,800			4,800
	10 year			4,800		4,800
	15 year			4,800		4,800
	Subtotal		14,400	9,600		24,000
4 Investment bond	10 year			3,600		3,600
	15 year			3,600		3,600
	Subtotal			7,200		7,200
5 National construction bond	2 year				5,000	5,000
6 Foreign currency bond						0
Subtotal by tenure	up to 1 year	20,800	0	0	0	20,800
	2 year	0	4,800	0	5,000	9,800
	3 year	0	4,800	0	0	4,800
	5 year	0	4,800	0	0	4,800
	10 year	0	0	8,400	0	8,400
	15 year	0	0	8,400	0	8,400
<b>Grand total</b>		<b>20,800</b>	<b>14,400</b>	<b>16,800</b>	<b>5,000</b>	<b>57,000</b>

Unit: Billion VND

Data source: Author's example schematization

### 3.1.4. Announce annual auction and underwriting plan

At current MOF has no predetermined schedule of auction and underwriting for a year. This means that no one can know and predict the number and volume of both auctions and underwritings by type of government bonds for a particular year. Should it become available, investors and intermediaries could be better prepared in advance to bid for and subscribe for government bonds.

Therefore MOF is suggested to elaborate and announce, from the earliest possible near future, annual auction and underwriting plans of government bonds by type and by issuance mode.

Table & Chart 3-4: Example of annual auction and underwriting plan (2008)

		Auction		Underwriting		Total
		Amount	Times	Amount	Times	
1 Treasury bill	up to 1 year	800	26			20,800
2 Treasury bond	2 year	400	12			4,800
3 Centrally-run works bond	3 year	400	12			4,800
	5 year	400	12			4,800
	10 year			400	12	4,800
	15 year			400	12	4,800
	Subtotal					24,000
4 Investment bond	10 year			300	12	3,600
	15 year			300	12	3,600
	Subtotal					7,200
<b>Grand total</b>					<b>52,000</b>	

Unit: Billion VND

Data source: Author's example schematization

### 3.1.5. Announce quarterly auction and underwriting calendar

MOF is also suggested to elaborate and announce, from the earliest possible near future, quarterly auction and underwriting plans of government bonds by type and by issuance mode, which shall make investors and intermediaries be better prepared too.

Table & Chart 3-5: Example of quarterly auction and underwriting plan (2008)

Date	Product	Amount
2-Jan	T-bill	800
9-Jan	2 year	400
	5 year	400
16-Jan	T-bill	800
23-Jan	3 year	400
30-Jan	T-bill	800
6-Feb	2 year	400
	5 year	400
13-Feb	T-bill	800
20-Feb	3 year	400
27-Feb	T-bill	800
5-Mar	2 year	400
	5 year	400
12-Mar	T-bill	800
19-Mar	3 year	400
26-Mar	T-bill	800

Unit: Billion VND

Data source: Author's example schematization

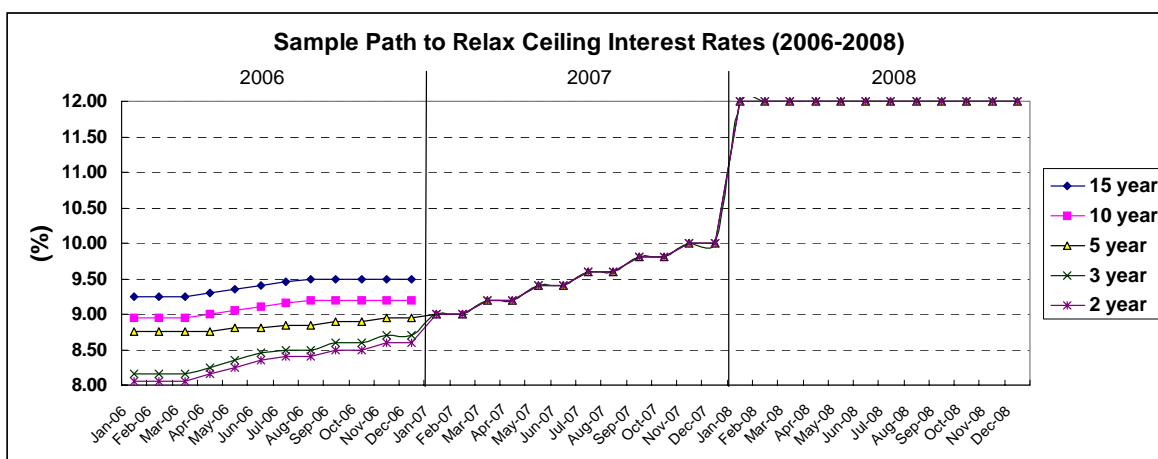
### 3.1.6. Relax ceiling interest rates

Relaxation of ceiling interest rates is one of key conditionality for PD to work, while its abolishment in the immediate timeframe may not necessarily be a prerequisite. If designed carefully, PD may be able to facilitate shifting of governmental control over the primary market of government bonds from price to volume.

Therefore MOF is suggested to gradually relax ceiling interest rates as per suggested as follows:

- 1) During 2006, by narrowing gap or spread of ceiling interest rates between 2-3 years and 5 year, MOF may want to see if it distorts and curtails investor's preference on 2-3 years bonds.
- 2) During 2007, by merging ceiling interest rates of up to 5-year into 5-year only, MOF will be able to see market price for 2-3 years bonds more realistically and hence be able to set the ceiling interest rate more flexibly in response to market sentiments. If 10-15 years bonds are concentrated to underwriting only, then MOF needs no longer to maintain ceiling interest rates for 10-15 years.
- 3) During 2008, by setting the merged ceiling interest rate of up to 5-year at around long-term prime rates, i.e. the least lending rate by commercial banks to most preferred borrowers, MOF will be able to see the reality of market preference and sentiment. Under this circumstance, MOF is also going to see if and how the auction, with underwriting being suspended, becomes competitive in actual.
- 4) During 2009 or afterwards, MOF may want to examine the abolishment of ceiling interest rates, provided the auction has become competitive.

Table & Chart 3-6: Example path to relax ceiling interest rates (2006-2008)



Data source: Author's example schematization

### 3.1.7. Reopen

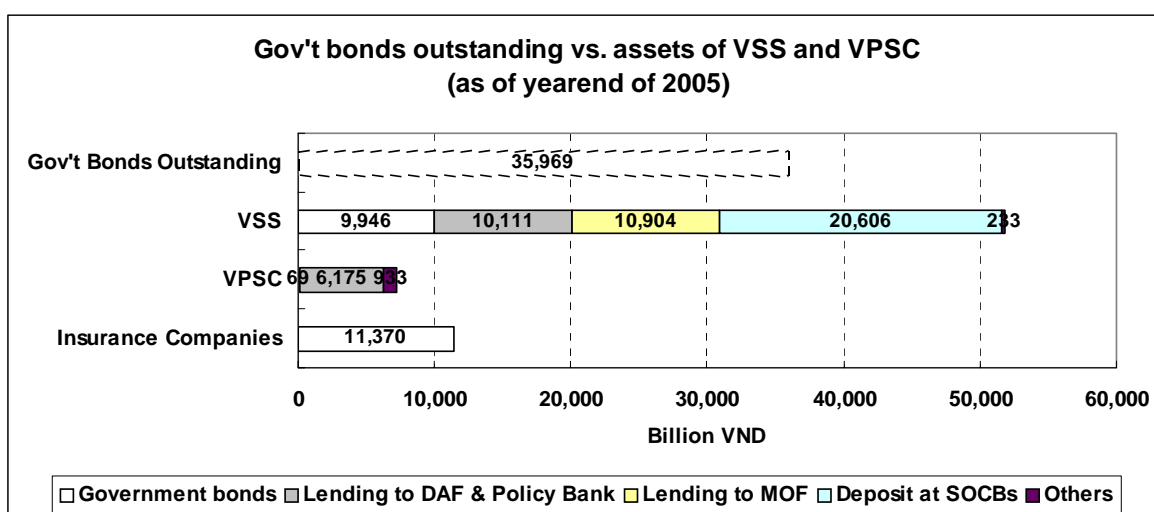
Scattered issuance mode, scattered numbers of issuance, and scattered size per issuance but each with different coupon and tenure, have all together made it very difficult for intermediaries to price and trade government bonds at the secondary market. Moreover, almost all of government bonds, except for T-bills, are sold at par at current, presumably in order for MOF to maintain the effectiveness of ceiling interest rates much easier. Nevertheless, Circulars Nos. 21 and 29 allow government bonds to be sold below or above par respectively through auction and underwriting.

Therefore MOF is suggested to introduce the operation of reopen, so as to maximize issuance size and hence to make the pricing and trading much easier. Needless to say, the reopen makes sense only if and after MOF at least relaxes and lifts the ceiling interest rates to the long-term prime rates or more preferably abolishes it.

### 3.1.8. Diversify investor base

Diversifying and expanding the investor base is not necessarily a prerequisite but one of favorable conditions for PD to works effectively. VSS and VPSC, for example, hold enormous assets, large proportion of which are directly lent out to DAF and MOF as per instructed by MOF, and small part of which are invested in government bonds. Should MOF allow them to shift investment portfolio from directed lending to government bonds, it would be contributory significantly to diversification and expansion of investor base and hence for PD to function more efficiently. Also, enhancing institutional investors such as investment funds and private pensions may be of contributory.

Table & Chart 3-7: Comparison in size of VSS/VPSC and government bonds



Note 1: Government bonds outstanding here includes listed ones only.

Note 2: Data for insurance companies, as of 23 January 2006.

Data source: MOF, VPSC and NRI's rough estimate for VSS.

### **3.1.9. Strengthen domestic debt management**

There still remains not a little discrepancy of data, even on issuance, among the State Treasury, SBV and STCs, as a matter of fact. Without accurate data on issuance, subscription and trading, MOF may not be able to assess and monitor obligations and performances of PDs in a proper and meaningful manner.

Therefore MOF at first is suggested to reconcile data monthly and to centralize the master file of database. Thereafter, domestic debt management in a more enhanced manner such as analyzing of and counteracting to portfolio risks shall need to follow. In order to facilitate this strengthening, MOF may want to examine the possibility of establishing a debt management office.

### **3.2. Reform of the Secondary Market**

A number of challenges relevant to secondary market, such as low liquidity and lack of market makers, originate from challenges of the primary market. Nonetheless, there are a few reforms at the secondary market as follows, which are in fact more or less independent to the primary market.

#### **3.2.1. Amend the reporting regime of STC**

Price information of outright transactions will function as the basis for trading in the secondary market, and is also a prerequisite to implement mark-to-market requirements and to introduce international-standard repo, both of which are indispensable for improving liquidity in the secondary market. Therefore STC is suggested to amend the reporting requirement to its member securities companies so that reporting shall be separately made between outright and repo (or short-term financing) transactions.

In order to support STCs, MOF and VSA may issue regulations on, respectively, repo and master repo agreement, as SBV and VBA have done so.

#### **3.2.2. Introduce buyback.**

The problem of scattered issuance per auction/underwriting is not only addressed by reopen, but also solved by buyback operations as well. Buy-back is a repurchase of government bonds prior to maturity. New on-the-run liquid bonds can be issued to replace the old bonds by operating buy-back. Although it is not easy to address the issues such as narrow investor base or narrow intermediary base, improvement of issue size per series itself will naturally increase the number of players that trade these bonds, therefore would contribute to liquidity. Therefore MOF is suggested to introduce the buyback, in parallel with efforts to introduce the reopen.

## 4. Next Steps towards PD

### 4.1. Stepwise Approaches for Introducing PD

#### 4.1.1. Monitor candidate PDs

Firstly, MOF is suggested to identify and monitor PD candidates, supposedly during 2007. A set of necessary sub-steps may include:

- Identify candidate PDs.
- Identify benchmark bonds.
- Monitor auction and underwriting results for a year.
- Monitor trading results for a year.

#### 4.1.2. Pilot-test PD

Secondary, MOF is suggested to pilot-test the PD system, supposedly during 2008. A set of necessary sub-steps may include:

- Design a tentative PD scheme (designator, membership, target securities, target transactions, obligations and privileges).
- Amend regulations (namely, Decree 141, Circular 29 and Circular 21).
- Pilot-test PD and monitor their performances.

Table & Chart 4-1: Example of PD pilot-test scheme in Vietnam (2008)

<b>Designator</b>		➤ <b>MOF</b>
<b>Membership</b>		➤ <b>Banks and securities companies who clear minimum bidding and successful bidding commitments.</b>
<b>Target Securities</b>		➤ <b>Government securities with tenures of up to 5 years.</b>
<b>Target Transactions</b>	<b>Primary Market</b>	➤ <b>Auction, only.</b> ➤ <b>Retail excluded.</b>
	<b>Secondary Market</b>	➤ <b>Outright buy/sell (for reference price), only.</b> ➤ <b>Repo excluded.</b>
<b>Obligations</b>	<b>Primary Market</b>	➤ <b>Minimum bidding commitment by tenure (around 5 to 10% of issue amount per month, quarter and/or year).</b> ➤ <b>Minimum successful bidding commitment by tenure (around 3 to 5% of issue amount per quarter and/or year).</b>
	<b>Secondary Market</b>	➤ <b>Reference price quoting (indicative, not firm).</b>
<b>Privileges</b>		➤ <b>Exclusive access to auctions.</b>

Source: Author's example schematization

### 4.1.3. Introduce and redesign PD

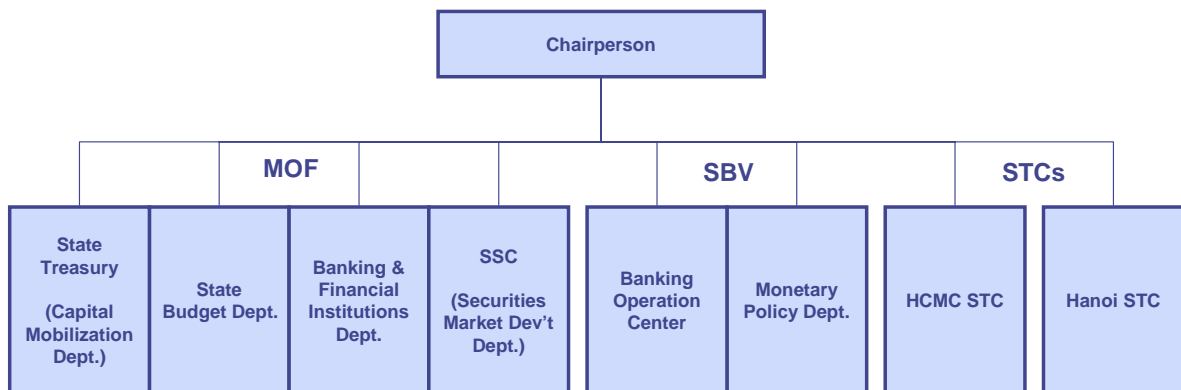
Thirdly, MOF is suggested to identify and monitor PD candidates, supposedly during 2009. A set of necessary sub-steps may include:

- Designate PDs
- Monitor PDs performances
- Redesign PD scheme by reflecting PDs performances

### 4.2. Implementation Formation

Reforms of both primary and secondary markets shall necessitate enormous efforts and changes in the way of business among relevant authorities and market participants. Therefore MOF is suggested to establish the formation of “Government Bonds Reform Committee” or alike at the earliest possible near future, in order to implement such reforms and to introduce PD. Should MOF want to establish a domestic debt management office, then such a committee or alike might facilitate its process.

Table & Chart 4-2: Example of structure of Government Bonds Reform Committee



Source: Author's schematization



### 4.3. Suggested Roadmap towards PD

In terms of timeline, suggested below is a roadmap for introducing PD in Vietnam.

Table & Chart 4-3: Suggested Roadmap towards PD

		2006	2007	2008	2009	2010	
3.1. Reform the primary market	3.1.1. Concentrate 2,3,5 years bonds to auction	Shift gradually					
	3.1.2. Concentrate 10-15 years bonds to underwriting	Concentrate					
	3.1.3. Announce annual issuance plan 3.1.4. Announce annual auction and underwriting plan 3.1.5. Announce quarterly auction and underwriting calendar		Start to announce				
	3.1.6. Relax ceiling interest rates	Narrow the gap	Merge to 5 years	Set at prime rate	Examine abolishing		
	3.1.7. Reopen	Examine regulations and taxation		Start to reopen			
	3.1.8. Diversify investor base	Encourage VSS and VPSC to buy in		Enhance other institutional investors			
	3.1.9. Strengthen domestic debt management	Reconcile data	Centralize database	Deepen domestic debt management			
	3.2. Reform the secondary market	3.2.1. Amend the reporting requirement	Amend a regulation	Start to require			
		3.2.2.. Buyback		Examine a regulation	Start to buyback		
4.1. Stepwise Approach for Introducing PD			Monitor PD candidates	Pilot-test PD	Introduce PD	Redesign PD	

Source: Author's schematization

## **II. Section II: TA Activities**

### **1. Outline of the TA**

#### **1.1. Formation**

##### **1.1.1. Counterpart / Recipient**

Ministry of Finance (MOF), Vietnam

- International Relations Department
  - Capital Market Division, Banking and Financial Institutions Department
- <http://www.mof.gov.vn/DefaultE.aspx?tabid=197>

##### **1.1.2. Provider / Sponsor**

Ministry of Finance (MOF), Japan

- Research Division, International Bureau
- <http://www.mof.go.jp/english/index.htm>

##### **1.1.3. Consultant**

Nomura Research Institute (NRI)

- in association with Institute for International Monetary Affairs (IIMA)
- <http://www.nri.co.jp/english/index.html>  
<http://www.iima.or.jp/english.htm>

#### **1.2. Period and Field Missions**

The technical assistance took place from October 2005 to March 2006, during when the consultant made total of five field missions as follows.

- 1<sup>st</sup>: late October to early November, 2005
- 2<sup>nd</sup>: late November to early December, 2005
- 3<sup>rd</sup>: early January to late January, 2006
- 4<sup>th</sup>: late February to early March, 2006
- 5<sup>th</sup>: mid March, 2006

During the course of the technical assistance, MOF organized an introductory seminar in late November and a feedback workshop in mid March, both in Hanoi, in order for increasing the awareness and understanding of the market participants on PD and for facilitating the constructive discussions among them.

## 2. Seminar and Workshop

### 2.1. Introductory Seminar

#### 2.1.1. Outline

- Organizer: MOF Vietnam
- Participants: SSC, SBV, banks, securities houses, insurers, donors, etc.  
(about 40 participants besides organizer and presenter)
- Presenter: NRI
- Date: November 30 (Wed), 2005
- Venue: Guoman Hotel, Hanoi
- Objectives
  - (1) Explanation of this Technical Assistance on PD,
  - (2) Discussion on the rational and necessity for examining PD, and
  - (3) Sharing common understanding of PD concept with ASEAN+3 cases.

#### 2.1.2. Program

- 09:00 *"Introduction,"* Mr. Nguyen Ba Toan, Deputy Director General, International Relations Department, MOF Vietnam
- 09:10 *"Issues on Developing of Government Bonds in Vietnam,"* Mr. Nguyen Hoang Duong, Deputy Director, Capital Market Division, Banking and Financial Institutions Department, MOF Vietnam
- 09:40 *"Introduction of PD System: Concept and Case Studies,"* Mr. Manabu Tsurutani, Sr. Consultant, Nomura Research Institute (NRI)
- 10:15 Tea break
- 10:30 *"Analytical Approach and Hypothesis,"* Mr. Kengo Mizuno, Sr. Consultant, Nomura Research Institute (NRI)
- 11:15 Comments and Discussions
- 12:00 Closing Remark

#### 2.1.3. Comments and discussions

##### MOF's recognition of issues

- Size of bond market is still small, and secondary market is underdeveloped.
- There is a sort of issuance plan, but it is not a concrete one and undisclosed.
- Issuance modes are scattered. If and when PD is introduced, retail channel ought to be suspended.
- Benchmark yield curve is unavailable yet but in necessity.
- Soon after the completion of this TA by March 2006, pilot test of PD shall take place from April to December 2006. Thereafter PD shall be introduced from year 2007.

##### Comments from participants

- Ceiling interest rate impedes the development of bond market. PD needs to be designed to facilitate lifting the ceiling interest rate. NRI is suggested to compare carefully between ceiling interest rates of government bonds and

- deposit and lending rate of the banking sector which is rather liberalized.
- Institutional investors are subject to corporate income tax on income gains, but retail investors are not. If both parties are treated equally and fairly, then the bond market shall be further promoted.
  - Privileges of PD member shall include tax incentive, if MOF wants to impose a number of obligations.
  - DVP is already practiced in a sense that buyers are required to prepay a deposit of full amount at their securities company's account. As such, counterparty risk is minimized in Vietnam.
  - Lead-time of settlement through HCMC Securities Trading Center has recently curtailed from T+3 to T+1.
  - Still secondary trading is too little to offer the firm quotes of buying and selling prices. Even if it becomes obligatory to PD member, none of them may be able to make market under such situation. NRI may want to analyze this matter quantitatively.

## 2.2. Feedback Workshop

### 2.2.1. Outline

- Organizer: MOF Vietnam
- Participants: SSC, SBV, banks, securities houses, insures, donors, etc.  
(about 60 participants besides organizer and presenter)
- Presenter: NRI
- Date: March 13 (Mon), 2006
- Venue: Hotel Nikko Hanoi
- Objectives
  - (1) Feedback of findings and suggestions by NRI
  - (2) Discussion on necessary reforms towards PD in Vietnam
  - (3) Discussion on next steps in the coming years

### 2.2.2. Program

- 08:30 Registration
- 09:00 Opening Remark
- 09:05 *"Introduction,"* Mr. Nguyen Hoang Duong, Deputy Director General, Banking and Financial Institutions Department, MOF Vietnam
- 09:15 *"Prerequisites for PD to Work: Lessons from ASEAN+3 Countries and Implications to Vietnam,"* Mr. Manabu Tsurutani, Sr. Consultant, Nomura Research Institute (NRI)
- 09:50 *"Findings and Suggestions for Introducing PD in Vietnam,"* Mr. Kengo Mizuno, Sr. Consultant, Nomura Research Institute (NRI)
- 10:30 Tea break
- 10:45 Open discussions
- 11:55 Closing Remark
- 12:00 Luncheon

### 2.2.3. Comments and discussions

#### MOF's recognition of issues

- The number of bidders is just a few per auction, making it very difficult for MOF to abolish ceiling interest rates. Otherwise, overpriced bidding may prevail, costing extremely high to MOF.
- Underwriting in Vietnam is unscheduled and flexible enough to negotiate with investors and intermediaries about tenure, volume, timing, etc. From the viewpoint of MOF as an issuer, administration of underwriting is much easier than organizing an auction.
- It may take several years to introduce the PD system, but anyway it is recognized as one of top priorities for MOF. Examination of PD is included in the draft Decision on orientation for development of capital markets up to 2010, which shall be promulgated in 2006.

#### Comments from participants

- Fee structure for securities houses is regulated by SSC, and differs between underwriting and auction. In the simplest term, the underwriting fee is double the successful auction fee, and hence securities houses are naturally interested in underwriting rather than auction.
- Most market participants may appreciate the reform of the market structure, suggested by NRI, which however MOF needs to expedite. In particular, ceiling interest rate must be abolished as soon as possible so that the market mechanism may function more precisely.
- Obligations of PD member, especially minimum bidding quotas for bidding and successful bidding, need to be studied more carefully in consideration of candidate member's capacities of absorption. It is likely to become tradeoff. The stricter the quotas are, the lesser the competition occurs. The little the quotas are, the lesser the exclusivity of privilege works.
- Investors may feel more comfortable, if MOF uses mobilized funds much more efficiently and effectively by allocating it to socially and economically profitable projects.

### 2.2.4. Press release

MOF Vietnam has made a press release on this feedback workshop, which has prevailed on a number of medias in Vietnamese and English. Among them, linked below is an article on the workshop by MOF itself.

*"Workshop on primary dealership for government bond in Vietnam"*

<http://www.mof.gov.vn/DefaultE.aspx?tabid=632&ItemID=31762>

### 3. Achievements and Lessons

#### 3.1. Achievements

##### 3.1.1. Awareness building

This technical assistance was first of its kind to discuss officially and publicly about the PD system in Vietnam. As definition and function of the PD systems varies country to country, NRI provided the market participants of both public and private sectors with case studies of the PD systems with particular emphasis on ASEAN+3 region, through the introductory seminar and the feedback workshop. NRI believes that the technical assistance has contributed to awareness building of not only the TA counterpart but also the market participants on PD.

##### 3.1.2. Reform orientation

During the course of technical assistance, intensively discussed between MOF as the TA counterpart and NRI were a number of bottom-line issues including, but not necessarily limited to, ceiling interest rates, scattered issuance modes, unclear issuance schedule, limited variety of end-investor base, limited number of successful bidders and underwriters, limited number of active intermediaries in secondary market, etc. This technical assistance identified and listed up all such bottom-line issues of the government bond market in Vietnam at one place and to make it open to the market players for discussion among them. Also, it was recognized that, as prerequisites for introducing PD and for making it to work effectively, structural reforms of both primary and secondary market must come first and are severely needed indeed. NRI believes that this technical assistance has been the very first attempt to draw overall pictures of such issues and reform orientation in necessity for introducing PD in Vietnam.

##### 3.1.3. Data analysis

Data on bond market, both primary and secondary market, was scarce and scattered, and remained mostly undisclosed to the public in Vietnam. Vietnam has no domestic debt management office or alike, and data on primary and secondary market is scattered and spread over a number of organizations, making it very difficult for anyone, especially market participants, to have an overall picture. During the course of the technical assistance, enormous efforts were made on collecting, aggregating and screening the numerous data by Banking and Financial Institutions Department of MOF and NRI. NRI believes that this technical assistance has served as a very scarce opportunity to undergo data mining and data analysis in Vietnam where sensitivity on information, especially on data, remains to a large extent. Moreover, such data analysis was disclosed to participants of the feedback workshop, so that the market participants can also know and share the market data.

### 3.2. Lessons

While this technical assistance has been first of its kind to undergo a full range of data mining, its quantitative analysis is still preliminary more or less. Indeed, there remains not a little discrepancy and inconsistency in original data and NRI encountered with difficulty in deepening data analysis. Such original data of primary and secondary markets are recorded in and collected from State Treasury, Securities Trading Centers, and SBV. Most seemingly, they don't necessarily share data at all time and their manner of data transmission each other is through paper documentations at most. Therefore, at different organizations and at different levels, there may be several of duplicated data recordings, which most likely increases chances of inaccuracy in recordkeeping. Moreover, they seem to seldom reconcile data each other. While NRI do appreciate for enormous efforts by Banking and Financial Institutions Department and International Relations Department in collecting relevant data from different sources, it still may be worth establishing a committee along with working groups involving bookkeepers of data on the bond market more closely. This lesson learned from the technical assistance is accordingly reflected in next steps of this report, which suggests Vietnam to establish Bond Market Reform Committee or alike.