3. Necessary Reforms for PD to Work

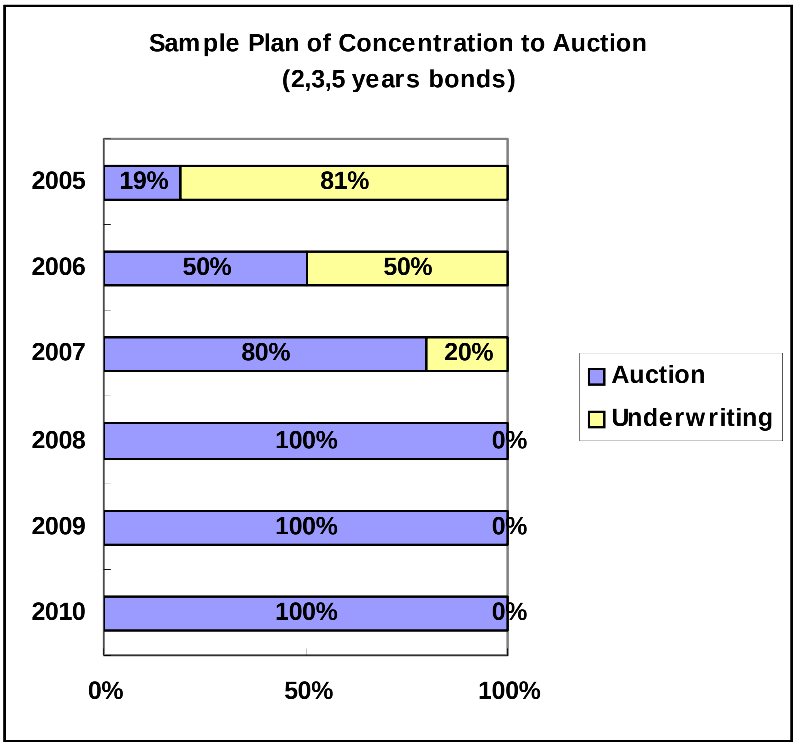
3.1. Reform of the Primary Market

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



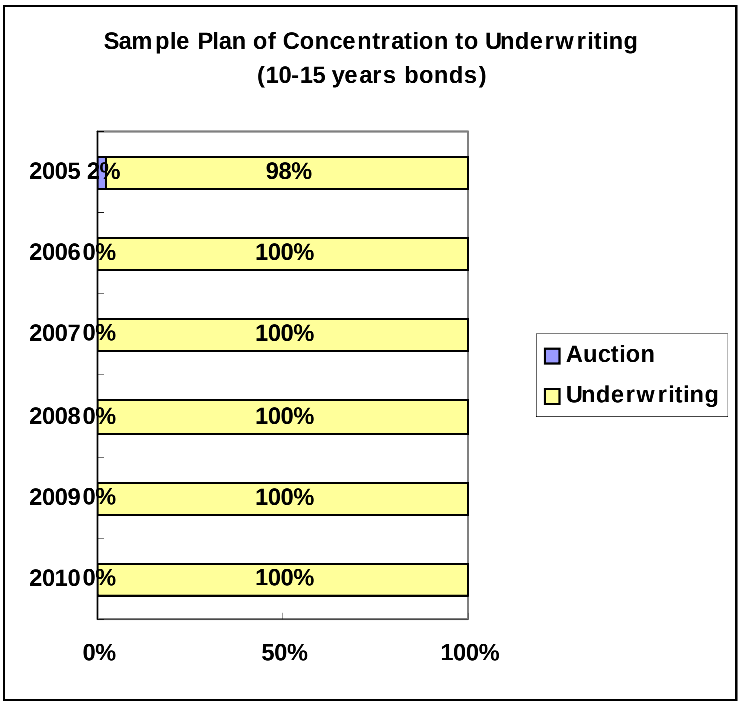
Data source: MOF for 2005; NRI's example schematization for 2006-2010

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[10], 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

[10] 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 Nattional 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
Grand total		20,800	14,400	16,800	5,000	57,000

Unite: 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
Grand total						52,000

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

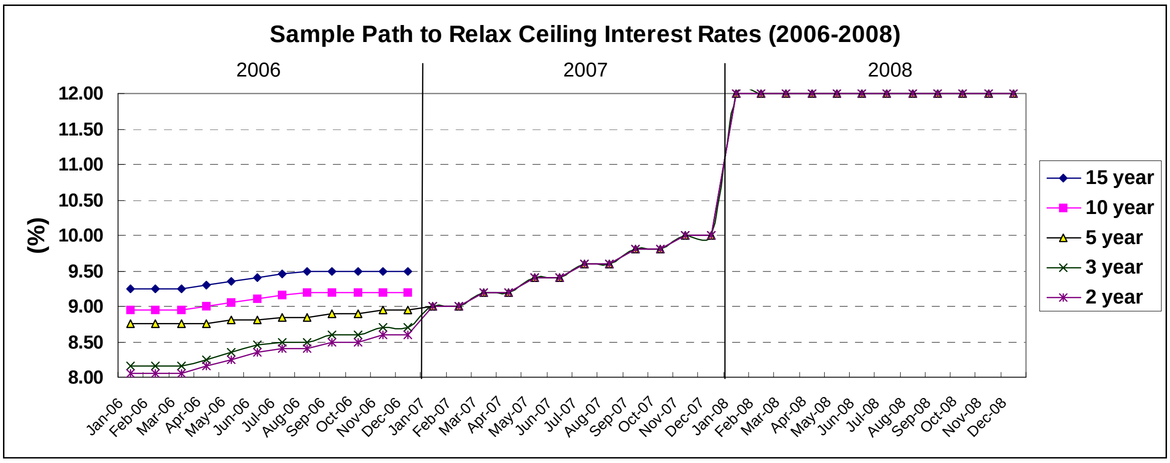
3.1.6. Relax ceiling interest rates

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

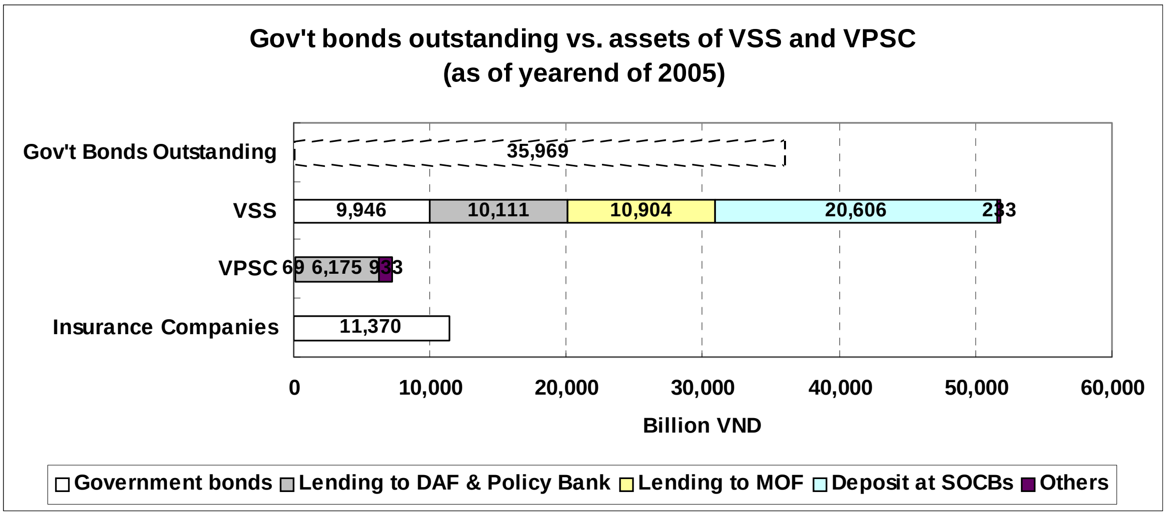
Scattered issuance mode, scattered numbers of issuance, and scattered size per issuance but each with different coupon and tenure, have all together made it very difficult for intermediaries to price and trade government bonds at the secondary market. Moreover, almost all of government bonds, except 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.