

Viet Nam: Improving Public Expenditure Quality Program

STRENGTHENING FISCAL RISK MANAGEMENT OF GOVERNMENT GUARANTEED LOANS



This brief summarizes the findings of policy advice prepared by the Asian Development Bank (ADB) for the Viet Nam Ministry of Finance (MOF) to support improvements in the fiscal risk management of government loan guarantees.¹

A. Background

The Government of Viet Nam has used loan guarantee instruments widely to support its ambitious public investment program. Most loan guarantees have been issued to state-owned enterprises (SOEs) that have limited capacity to borrow from international markets. These loan guarantees enabled SOEs to mobilize finance to invest in the energy sector (62%), aviation (17%), and road (6%), cement (4%), mining (3%) and others (7%).^{2,3}

Viet Nam's use of loan guarantees has helped lower borrowing costs and mobilize finance for critical national development projects. Yet, the depth and coverage of these guarantees has also created fiscal risks. As of end 2016, the government had approximately \$20 billion in guaranteed debts, mostly for SOEs, accounting for 18% of the government's total debt stock.⁴ The potential fiscal risks created by these guarantees also tend to become most severe during a fiscal crisis.

In response, the government has taken steps to better manage the fiscal risks on the state budget and fiscal sustainability brought about by government guarantees. The government has tightened rules⁵ to reduce the size of the guarantee portfolio by restricting new guarantees to a smaller set of priority sectors and reducing the guarantee limit from 80% to 70% of the total project investment amount. A state-owned guarantee "accumulation fund"⁶ has also been established, managed by the MOF. The accumulation fund collects fees charged to guarantee users. These funds are used to shield the state budget from future possible indemnifications. For instance, in the case a borrower cannot repay a guaranteed loan, the accumulation fund will repay the loan on their behalf which the borrower is required to repay based on an agreed schedule.

While these are positive steps in the government's broader efforts to manage the fiscal risks associated with government guarantees, several challenging issues remain in establishing sounder risk management practices.

B. Key Issues for Risk Management of Government Loan Guarantees

Lack of reliable credit risk profiles. Vietnamese entities that receive government guarantees lack updated audited financial data. Audited financial statements are usually not submitted until 6 months to 1 year after the end of the financial year. This undermines the ability of the MOF to conduct rigorous credit risk assessments before issuing new guarantees. In many countries, governments rely on commercial rating agencies to support risk assessment. However there is presently no reliable local rating agency in Viet Nam. Some information is available through the Credit Information Centre under the State Bank of Viet Nam, but this only includes information about past payment experience (credit overdues, etc.) and does not offer information about future liquidity or repayment risks. A new accounting law⁷ strengthening audit and financial statement requirements of enterprises was approved in 2015 and effective from 1 January 2017 but will take time to implement.

Insufficient revenue collection from guarantee fees. A fundamental principle of establishing an effective accumulation fund is to charge a fee that corresponds to the expected cost of the guarantee. An expected cost arises because of a probability that the recipient of a guarantee will not be able to fulfil their undertaking, which usually results in a credit loss for central government. The expected costs consist of both expected credit loss and the administrative costs associated with the guarantee. The present fee structure for guarantee users in Viet Nam is however too low to meet this benchmark. Fee ranges are narrow, (up to 2% per annum) so are unable to be priced against a wide spectrum of risks. In most cases, fees are only just sufficient to cover the administrative costs of the guarantee, leaving little room to build a sufficient buffer within the accumulation fund.

Inadequate staff capacity to judge credit risks. The division responsible for issuing and managing government guarantees within the MOF is relatively small compared to the size of Viet Nam's guarantee portfolio. It currently consists of seven staff (although with several vacancies). Staff typically have no specific professional background in credit risk assessments (at banks or similar) and the pricing practice until now has been relatively ad hoc, with little consideration of risk factors driving the fees, or decision to issue the guarantee.

¹ Sovereign credit guarantees can be defined as liabilities based on loan agreements through which the government assumes a part or all the credit risk of a loan extended to another party.

² Previously some corporations in cement and paper production were provided with government guarantees. However, since 2010, the government has ceased its issuance of government guarantees for such industries.

³ This policy brief refers only to explicit loan guarantees issued to enterprises. The government also has a substantive program of "onlending" to provincial governments and provides guarantees to support bond issuances by state policy banks.

⁴ Of the guarantees for loans denominated in foreign currencies most (about 80%) are in US dollars, followed by euro (about 15%). The rest are in Japanese yen and other currencies.

⁵ Regulated by Decree 04/2017/NĐ-CP on Issuance and Management of Government Guarantees adopted by the Prime Minister on 16 January 2017.

⁶ The Accumulation Fund is regulated by Decision No. 01/2013/QĐ-TTg dated 7 January 2013.

⁷ Accounting Law (88/2015/QH13) was approved on 20 November 2015, effective on 1 January 2017.



Tellers attend to clients in a Viet Nam bank.

C. Short- to Medium-Term Reform Priorities

It is not possible to transform Viet Nam's guarantee risk management practices into international best practice standards overnight. A pragmatic approach is needed, where assessment methods are gradually improved, technical skills built, and the lack of financial information and access to historical payment data ameliorated. Based on an assessment of the specific context in Viet Nam, several next steps can be recommended. These include:

Develop clearer internal credit risk guidelines. A clearer methodology to judge credit risks of enterprises using government guarantees is needed. This should include detailed scoring guidelines to manage possible concerns of the relative subjectivity in scoring risk factors and to convince policy makers of the validity of risk assessment. To achieve this, a greater investment in staff capacity and their technical skills in the credit ratings is likely to be required.

Introduce credit risk score cards. Given the limited information on historic financial performance and credit events of beneficiaries in Viet Nam, a statistical model would be very difficult to implement. A credit score card approach will be simpler and more flexible in incorporating qualitative information and being specific to the risk exposure of the government. Routine credit scoring would help the MOF build capacity for a fundamental understanding of credit risks. This would facilitate ongoing credit monitoring and the implementation of risk mitigation measures. Advantages of this approach also include its ease of replication, transparency, and cost efficiency. MOF can use information on rating methodologies available from

international rating agencies—Standard & Poor's, Moody's and Fitch—when developing the score cards.

Develop a simple and transparent rating system. Once a suitable credit score card has been established, the MOF can begin to convert internal credit scores into letter ratings. While letter ratings could correspond to those of international rating agencies (very granular) at an early stage there is merit in working with less granular scales for the sake of simplicity. Either way, rating scales should be traceable to those of the international rating agencies. This increases the understanding, transparency, and the possibility to check whether the internal credit rating scale is well-balanced.

Establish a stronger link between credit risks and guarantee fees. Once the rating system has been established, the MOF can begin to convert ratings into default probabilities for the maturity of the guarantee by using information on historic defaults by rating and time horizon. These expected costs should then be mapped more closely to the determination of guarantee user fees. A challenge is that the government's own guarantee portfolio is too small a sample (with a limited historical perspective) to provide a basis for reliable probability of default data. Vietnamese commercial banks would typically have bigger samples, but data quality and availability may be unreliable. To supplement this information, the MOF may choose to purchase credit default information from the rating agencies (Standard & Poor's and Moody's). This data is widely used by national guarantee agencies and is of high quality and regularly updated. It can, however, involve substantial costs.

D. Longer-Term Reforms

Strategic evaluation of guarantee use. Although this brief focuses on guarantee risk assessments and pricing, these issues are only two steps in a wider process. Risk mitigation requires continuous monitoring efforts. Viet Nam also needs to review its use of government guarantees. In particular, the government may evaluate how to broaden the application of good practice guarantee risk assessment methods to other instruments of similar nature as enterprise guarantees. This will include the management of build-and-transfer infrastructure delivery models and in the execution of public-private partnerships.

Development of score cards—an iterative process. ADB has supported the MOF in taking the first steps in developing credit score cards for several priority sectors including energy and transport. However, the development of score cards is an iterative process. Longer time series and a broader data base is required if robust and reliable outcomes are to be achieved. Therefore, it is

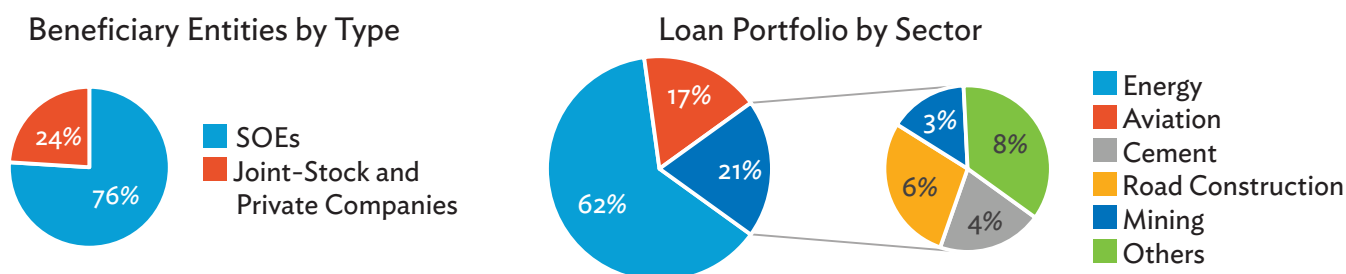
recommended that the scorecards should be reviewed and the weights revised periodically against updated empirical data and experience. This could be complemented by further research on credit rating methodologies from other rating agencies (e.g., by testing their corporate score cards). A revision of the first-generation score cards can include: changing and adding scoring factors; adding modifiers; and changing weights for factors.

ADB, through its Improving Public Expenditure Quality program, has provided policy and technical assistance to address critical public financial management weaknesses, increase the efficiency of public expenditure, and improve infrastructure and services for Viet Nam since 2014.

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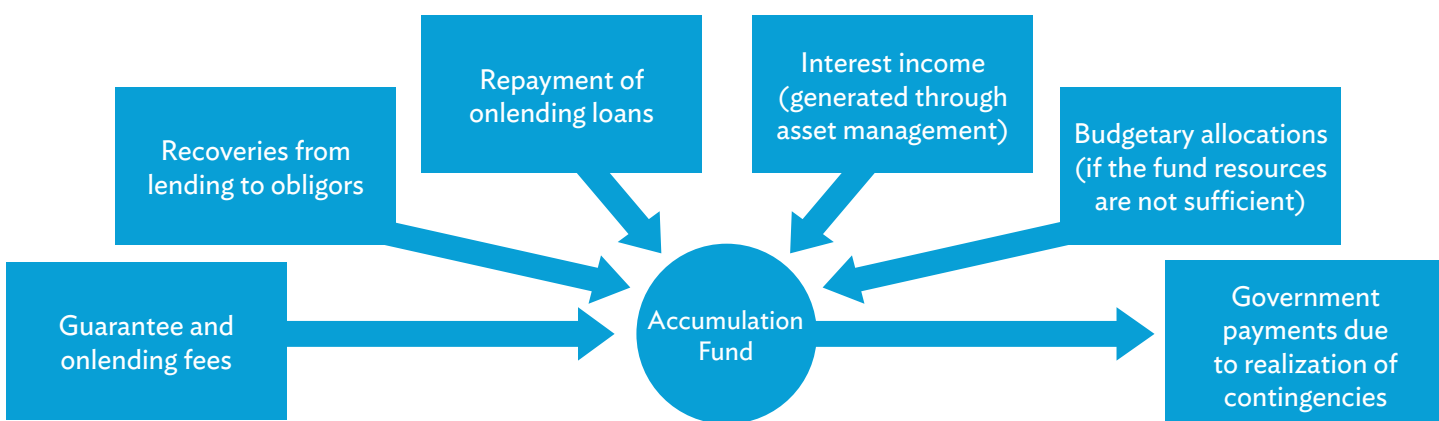
Figure 1: Summary of Guarantees



SOE = state-owned enterprise.

Source: E. Cassel. 2017. *Final report on Management of Government Guaranteed Loans—International Best Practices and Suitable Risk Assessment and Quantification Methods for Viet Nam*. Ha Noi, March.

Figure 2: Operation of the Accumulation Fund



Source: Cassel, Eva (2017), *Final report on Management of Government Guaranteed Loans – International Best Practices and Suitable Risk Assessment and Quantification Methods for Viet Nam*, Ha Noi, March.



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