



# Report and Recommendation of the President to the Board of Directors

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Project Number: 44251-013  
November 2013

## Proposed Programmatic Approach and Policy- Based Loan for Subprogram 1 Socialist Republic of Viet Nam: Financial Sector Deepening Program



## CURRENCY EQUIVALENTS

(as of 25 October 2013)

|               |   |             |
|---------------|---|-------------|
| Currency unit | – | dong (D)    |
| D1.00         | = | \$0.0000474 |
| \$1.00        | = | D21,085     |

## ABBREVIATIONS

|       |   |   |
|-------|---|---|
| ADB   | – | Asian Development Bank                      |
| ASEAN | – | Association of Southeast Asian Nations      |
| FSAP  | – | Financial Sector Assessment Program         |
| FSDP  | – | Financial Sector Deepening Program          |
| FSPL  | – | Financial Sector Program Loan               |
| GDP   | – | gross domestic product                      |
| HNX   | – | Ha Noi Stock Exchange                       |
| IFRS  | – | International Financial Reporting Standards |
| MOF   | – | Ministry of Finance                         |
| MMWG  | – | Money Market Working Group                  |
| ODA   | – | official development assistance             |
| SBV   | – | State Bank of Viet Nam                      |
| SDR   | – | special drawing rights                      |
| SEDS  | – | Socio-Economic Development Strategy         |
| SME   | – | small and medium-sized enterprises          |
| SOE   | – | state-owned enterprise                      |
| SSC   | – | State Securities Commission                 |
| TA    | – | technical assistance                        |
| VAS   | – | Viet Nam Accounting Standards               |

## NOTES

- (i) The fiscal year (FY) of the Government of Viet Nam and its agencies ends on 31 December.
- (ii) In this report, "\$" refers to US dollars.

|                         |   |
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## CONTENTS

|                                    | <b>Page</b> |
|------------------------------------|-------------|
| PROGRAM AT A GLANCE                |             |
| I. THE PROPOSAL                    | 1           |
| II. THE PROGRAM                    | 1           |
| A. Rationale                       | 1           |
| B. Impact and Outcome              | 5           |
| C. Outputs                         | 5           |
| D. Development Financing Needs     | 7           |
| E. Implementation Arrangements     | 8           |
| III. DUE DILIGENCE                 | 8           |
| A. Economic and Financial          | 8           |
| B. Governance                      | 8           |
| C. Poverty and Social              | 9           |
| D. Safeguards                      | 9           |
| E. Risks and Mitigating Measures   | 10          |
| IV. ASSURANCES                     | 10          |
| V. RECOMMENDATION                  | 10          |
| <br>                               |             |
| APPENDIXES                         |             |
| 1. Design And Monitoring Framework | 11          |
| 2. List of Linked Documents        | 14          |
| 3. Development Policy Letter       | 15          |
| 4. Policy Matrix                   | 20          |



## PROGRAM AT A GLANCE

|  |  |   |   |                           |  |                                      |  |                            |  |                          |   |
|--|--|---|---|---------------------------|--|--------------------------------------|--|----------------------------|--|--------------------------|---|
| <b>1. Project Name:</b> Policy-Based Loan for Subprogram 1 of Financial Sector Deepening Program |  | <b>2. Project Number:</b> 44251-013   |   |                           |  |                                      |  |                            |  |                          |   |
| <b>3. Country:</b> Viet Nam  |  | <b>4. Department/Division:</b> Southeast Asia Department/Public Management, Financial Sector, & Trade Division  |   |                           |  |                                      |  |                            |  |                          |   |
| <b>5. Sector Classification:</b>   |  |   |   |                           |  |                                      |  |                            |  |                          |   |
| <b>Sectors</b>   |  | <b>Primary</b>  | <b>Subsectors</b>   |                           |  |                                      |  |                            |  |                          |   |
| Finance  |  | √   | Finance sector development                                      |                           |  |                                      |  |                            |  |                          |   |
| <b>6. Thematic Classification:</b>   |  |   |   |                           |  |                                      |  |                            |  |                          |   |
| <b>Themes</b>  |  | <b>Primary</b>  | <b>Subthemes</b>  |                           |  |                                      |  |                            |  |                          |   |
| Economic growth  |  | √   | Promoting economic efficiency and enabling business environment |                           |  |                                      |  |                            |  |                          |   |
| Capacity development   |  |   | Organizational development                                      |                           |  |                                      |  |                            |  |                          |   |
| <b>6a. Climate Change Impact</b><br>No Climate Change Indicator available.                       |  | <b>6b. Gender Mainstreaming</b>   |   |                           |  |                                      |  |                            |  |                          |   |
|  |  | <table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 80%;">Gender equity theme (GEN)</td> <td style="width: 20%;"></td> </tr> <tr> <td>Effective gender mainstreaming (EGM)</td> <td></td> </tr> <tr> <td>Some gender benefits (SGB)</td> <td></td> </tr> <tr> <td>No gender elements (NGE)</td> <td style="text-align: center;">√</td> </tr> </table> |   | Gender equity theme (GEN) |  | Effective gender mainstreaming (EGM) |  | Some gender benefits (SGB) |  | No gender elements (NGE) | √ |
| Gender equity theme (GEN)  |  |   |   |                           |  |                                      |  |                            |  |                          |   |
| Effective gender mainstreaming (EGM)   |  |   |   |                           |  |                                      |  |                            |  |                          |   |
| Some gender benefits (SGB)   |  |   |   |                           |  |                                      |  |                            |  |                          |   |
| No gender elements (NGE)   | √  |   |   |                           |  |                                      |  |                            |  |                          |   |
| <b>7. Targeting Classification:</b>  |  | <b>8. Location Impact:</b>  |   |                           |  |                                      |  |                            |  |                          |   |
| <b>General Intervention</b>  | <b>Targeted Intervention</b>                     |   |   |                           |  |                                      |  |                            |  |                          |   |
|  | <b>Geographic dimensions of inclusive growth</b> | <b>Millennium development goals</b>   | <b>Income poverty at household level</b>                        |                           |  |                                      |  |                            |  |                          |   |
| √  |  |   |   |                           |  |                                      |  |                            |  |                          |   |
|  |  |   |   |                           |  |                                      |  |                            |  |                          |   |
|  |  |   |   |                           |  |                                      |  |                            |  |                          |   |
| <b>9. Project Risk Categorization:</b> Low   |  |   |   |                           |  |                                      |  |                            |  |                          |   |
| <b>10. Safeguards Categorization:</b>  |  |   |   |                           |  |                                      |  |                            |  |                          |   |
|  |  | Environment   | C   |                           |  |                                      |  |                            |  |                          |   |
|  |  | Involuntary resettlement  | C   |                           |  |                                      |  |                            |  |                          |   |
|  |  | Indigenous peoples  | C   |                           |  |                                      |  |                            |  |                          |   |
| <b>11. ADB Financing:</b>  |  |   |   |                           |  |                                      |  |                            |  |                          |   |
| <b>Sovereign/ Nonsovereign</b>   | <b>Modality</b>                                  | <b>Source</b>   | <b>Amount (\$ Million)</b>                                      |                           |  |                                      |  |                            |  |                          |   |
| Sovereign  | Program loan                                     | Asian Development Fund  | 45.0  |                           |  |                                      |  |                            |  |                          |   |
| Total  |  |   | 45.0  |                           |  |                                      |  |                            |  |                          |   |
| <b>12. Cofinancing:</b><br>No Cofinancing available.   |  |   |   |                           |  |                                      |  |                            |  |                          |   |
| <b>13. Counterpart Financing:</b><br>No Counterpart Financing available.                         |  |   |   |                           |  |                                      |  |                            |  |                          |   |
| <b>14. Aid Effectiveness:</b>  |  |   |   |                           |  |                                      |  |                            |  |                          |   |
| Parallel project implementation unit   |  | No  |   |                           |  |                                      |  |                            |  |                          |   |
| Program-based approach   |  | Yes   |   |                           |  |                                      |  |                            |  |                          |   |





## I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on (i) a proposed programmatic approach and (ii) a proposed policy-based loan for subprogram 1, both to the Socialist Republic of Viet Nam for the Financial Sector Deepening Program (FSDP).

2. The proposed FSDP will support initiatives under the Socio-Economic Development Strategy (SEDS), 2011–2020 to increase the role of the nonbank financial sector and deepen the financial markets in Viet Nam. In line with the country partnership strategy, 2012–2015 for Viet Nam, the FSDP aims to strengthen the legal, regulatory, and institutional frameworks and market infrastructure to sustain the financing of productive investment.<sup>1</sup> The FSDP is included in the country operations business plan, 2012–2014 for Viet Nam and will support the government in transitioning the country into a modern, productive, and equitable market-based economy.<sup>2</sup> The FSDP and its supporting project preparatory technical assistance (TA) will support the development of a well-functioning money market and a deeper and more liquid capital market, and it will improve the capacity of public and private institutions in the nonbank financial sector.<sup>3</sup> These focus areas have been discussed with all relevant government agencies, market and industry associations, and development partners.

## II. THE PROGRAM

### A. Rationale

3. The government's reform programs have helped the country reach lower middle-income status.<sup>4</sup> However, Viet Nam is now at a critical juncture and needs to sustain its development progress. The government aspires to achieve a higher middle-income status, with per capita income of at least \$3,000, along with significant improvements in human development and poverty reduction by 2020. To meet these goals, the SEDS focuses on structural reforms, environmental sustainability, social equity, and macroeconomic stability. The government has identified financial sector development as a key aspect of the reform agenda, which underlies all of these focus areas. Recognizing this, the Asian Development Bank (ADB) has adopted a "whole-of-sector" approach to support financial sector development in Viet Nam based on ongoing policy dialogue and regular financial sector assessments. The FSDP will complement and support interrelated and reinforcing effects to provide greater macroeconomic stability, increase the availability of credit to the corporate sector and small businesses, and facilitate structural reforms. The recent Financial Sector Assessment Program (FSAP) reconfirmed the need to prioritize the development of Viet Nam's financial sector to support bank recapitalization and to facilitate the restructuring of state-owned enterprises (SOEs).<sup>5</sup>

4. **ADB's comprehensive financial sector engagement.** ADB has supported financial sector development in Viet Nam with three successive clusters of financial sector program loans (FSPLs). FSPL1 supported the introduction of basic concepts and systems that represent the prerequisites to developing a market-based financial system and economy.<sup>6</sup> FSPL2 marked the

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<sup>1</sup> ADB. 2012. *Viet Nam: Country Partnership Strategy, 2012–2015*. Manila.

<sup>2</sup> ADB. 2011. *Viet Nam: Country Operations Business Plan, 2012–2014*. Manila.

<sup>3</sup> ADB. 2011. Concept Paper. Socialist Republic of Viet Nam: Financial Sector Deepening Program. Manila.

<sup>4</sup> With per capita income above \$1,036 based on the criteria set by the World Bank.

<sup>5</sup> International Monetary Fund and World Bank. 2013. *Financial Sector Assessment Program Report: Viet Nam*. Unpublished.

<sup>6</sup> ADB. 1996. *Report and Recommendations of the President to the Board of Directors: Proposed Program Loan to the Socialist Republic of Viet Nam for the Financial Sector Program Loan*. Manila.

beginning of ADB's emphasis on development of the nonbank financial sector. Building on the work started under FSPL1, the program strengthened capital markets, institutional investors, and nonbank financial intermediaries.<sup>7</sup> FSPL3 sought to increase alternative channels for market-based financial intermediation.<sup>8</sup> The program enhanced the securities issuance process, increased the supply and quality of assets available to investors, and supported the establishment of a Public Debt Management Office. These programs have been buttressed by a broader range of initiatives benefiting from ADB support, such as the Asian Bond Market Development Initiative. A wide range of bilateral and multilateral donors are also active in this sector, including the World Bank and the Canadian International Development Agency, which provide substantial levels of assistance to the banking sector.<sup>9</sup>

5. ADB is providing parallel targeted assistance to support and increase access to finance. The Second Small and Medium-Sized Enterprise (SME) Development Program provides measures to promote SME development, strengthen the framework for competition policy, and enhance SME access to finance.<sup>10</sup> At the same time, ADB is supporting the government's efforts to restructure SOEs. This program, which depends in large part on financial sector reform, aims to reduce the dominance of inefficient state production, promote private sector development, and enhance economic growth by freeing up financial resources to more productive uses. Under the SOE Reform and Corporate Governance Facilitation Program, participating SOEs will be restructured under a comprehensive package of corporate and financial reforms.<sup>11</sup> This initiative builds on an earlier ADB engagement that developed an enabling environment, including the creation of a centralized government institution to formulate, coordinate, and lead the implementation of SOE reform.

6. **Positive but measured results.** ADB financial sector programs have contributed to the emergence of a nascent yet fast-growing financial sector. Viet Nam's total local currency bonds outstanding grew 26.8% year-on-year to reach D578 trillion as of end-June 2013, similar to the 28.5% year-on-year increase recorded in June 2012. In fact, year-on-year Viet Nam was the fastest growing local currency bond market in emerging East Asia in the second quarter of 2013.<sup>12</sup> While private sector issuance has recently slowed, local currency corporate bonds increased to 0.5% of gross domestic product (GDP) in June 2013 from zero in June 2007.

7. The growth of the stock exchanges has far exceeded the government's initial target for a combined market capitalization of 10% of GDP by 2010. Combined stock market capitalization has increased to 23% of GDP as of the end of 2012, from zero in 2002. The Ho Chi Minh City Stock Exchange began operations in 2000 with just two listed companies. By 2012 it had grown to 308 listed stocks and a total market capitalization of D678 trillion. The Ha Noi Stock Exchange (HNX) opened in July 2005 with six listed companies. At year-end 2012, HNX reported 396 listed stocks, 448 listed government bonds, 18 listed treasury bills, and 132

<sup>7</sup> ADB. 2002. *Report and Recommendations of the President to the Board of Directors: Proposed Program Loan Cluster to the Socialist Republic of Viet Nam for the Financial Sector Program Loan II*. Manila.

<sup>8</sup> ADB. 2007. *Report and Recommendations of the President to the Board of Directors: Proposed Program Loan Cluster to the Socialist Republic of Viet Nam for the Financial Sector Program Loan III*. Manila.

<sup>9</sup> Development Coordination (accessible from the list of linked documents in Appendix 2).

<sup>10</sup> ADB. 2009. *Project Completion Report: Small and Medium-Sized Enterprise Development Program Cluster, Subprograms I and II*. Manila; ADB. 2012. *Report and Recommendations of the President to the Board of Directors: Programmatic Approach, Policy-Based Loan for Subprogram 1, and Administration of Technical Assistance Grant for the Microfinance Development Program*. Manila.

<sup>11</sup> ADB. 2009. *Report and Recommendations of the President to the Board of Directors: Multitranche Financing Facility for the SOE Reform and Corporate Governance Facilitation Program*. Manila.

<sup>12</sup> Emerging East Asia includes the People's Republic of China; Hong Kong, China; Indonesia; the Republic of Korea; Malaysia; the Philippines; Singapore; Thailand; and Viet Nam.

registered over-the-counter stocks (Unlisted Public Company Market). A contractual savings industry has also begun to emerge as a precursor for an enlarged investor base. While the commercial insurance market in Viet Nam only began in 1993, the market has grown rapidly in terms of premiums, products on offer, and diversity. Penetration rates at 1.4% of GDP are comparable to those of Indonesia and the Philippines.

8. Accordingly, the country assistance program evaluation recorded a borderline *successful* overall finance sector assistance rating for Viet Nam over the period 1999–2008.<sup>13</sup> In particular, the country assistance program evaluation described ADB's engagement as a logical sequencing of reforms beginning with the basic frameworks and then expanding to more complex reforms. Likewise, the special evaluation study on ADB Assistance for Domestic Capital Market Development rated ADB's capital markets assistance in Viet Nam *successful*.<sup>14</sup> ADB's assistance was regarded as highly selective and well sequenced, while benefiting from substantial aid coordination. However, both studies recognized that the establishment of a sound financial system and capital markets is a long-term process and that Viet Nam was likely to require more time and additional capacity development support to be able to move towards full compliance with international standards.

9. This observation was further validated during program implementation. Preliminary assessments indicate that as FSPL3 began calling for increasingly complex reforms, difficulties in managing the required coordination between government agencies produced protracted implementation periods. For example, the government is only now beginning to address the need to recapitalize the banking sector and restructure SOEs, both of which are needed to provide incentives for capital market development. In addition, the scale of TA provided to support early programs proved insufficient. These issues manifested themselves through the emergence of compliance-based program implementation in which policy reforms were implemented and documented, and yet lacked effectiveness.

10. **Remaining challenges.** The government has recognized that a more focused and sustained effort is required to deepen Viet Nam's financial sector and to sustain the financing of economic development. The money market remains small and extremely fragmented. Turnover is low and tenors are very short. Activity has been constrained by restrictive regulations, a lack of an enabling infrastructure, and the inability of participants to obtain qualitative and reliable credit assessments. Standardized agreements have not been adopted by the private sector, such as in the case of repos, and transparency is poor. Until these issues are addressed, macroeconomic stability will remain elusive as authorities are forced to rely on less efficient policy tools such as control of the monetary base.

11. Viet Nam remains one of the smallest debt markets of emerging East Asia in terms of GDP and size. During 2009, the local currency bond market stagnated due to the global financial crisis. When combined with the overlay of other structural impediments, such as interest rate caps, issuance became problematic for all but the shortest maturities. At the end of the second quarter of 2013, the total local currency bond market represented only 14.8% of GDP, well below the overall average of 54.3% for emerging East Asia. Bond market development will be constrained in the absence of proper hedging mechanisms and instruments as these key risk management tools are necessary to support the development of market makers. Moreover, the contractual savings industry has not been supported with a development

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<sup>13</sup> ADB. 2009. *Country Assistance Program Evaluation: Viet Nam*. Manila. Housing finance projects performed poorly and some financial sector reforms were slow to develop.

<sup>14</sup> ADB. 2008. *Special Evaluation Study: ADB Assistance for Domestic Capital Market Development*. Manila.

plan sufficient to ensure the sector serves as a source of demand for longer duration capital market products.<sup>15</sup>

12. **The government's reform agenda.** Over the short term (2010–2013), the government introduced a number of initiatives aimed at strengthening the legal framework and providing an enabling environment to support the development of a short-term money market. As part of this effort, the State Bank of Viet Nam (SBV) will coordinate with the Ministry of Finance (MOF) and other stakeholders to introduce standardized repurchase agreements and to study the feasibility of launching alternative money market instruments. The SBV will increase the transparency of central bank operations within the money market. Over the longer term, the government will attempt to solve some of the more challenging issues, such as the SBV's independence and legal mandate.

13. The MOF and State Securities Commission (SSC) have completed the Sector Road Map for the Strategic Development of the Vietnamese Capital Market, which covers the years 2011–2020. This document serves as a master plan for long-term capital market development and addresses bottlenecks that impede its growth. A bond market development road map has been approved and adopted that includes both quantitative and qualitative targets. The government plans to increase outstanding local currency bonds to 38% of GDP by 2020 from 18% of GDP in 2011. A mechanism will be created to link treasury and debt management to ensure predictable, pre-announced debt auctions. The government also plans to develop a primary dealer system and to lay the foundations for market makers in both the primary market and secondary market. By identifying benchmark issues and lengthening maturities, the government will begin building a risk-free yield curve to establish reference rates. An enabling environment will be provided to develop the corporate bond market as well as the establishment of a domestic credit rating agency. These efforts will be backstopped by a road map to develop the insurance industry as a source of demand for capital market products.

14. To complement its overarching objectives, the SEDS provides for comprehensive capacity development throughout the financial sector, including for the SBV and MOF.<sup>16</sup> The strategy initially focuses on preparing the necessary conditions to implement comprehensive human resources development and training activities, which are necessary to support more complex policy reforms. From 2015 to 2020, the government will restructure training activities for the whole financial sector, including university education. To strengthen the underlying infrastructure of the financial sector, the government will establish an accounting and audit system that is compatible with Viet Nam's circumstances as well as regional and global standards, including the adoption of market or fair value. Mark-to-market is instrumental in providing incentives to encourage discipline through risk management and the development of key technical skills. Efforts will also be made to upgrade the clearing and settlement system and to establish a central clearing counterparty.

15. **The proposed program.** The design of the FSDP has incorporated the lessons learned. Financial sector development is recognized as hierarchical and requires careful sequencing to safeguard monetary and financial stability.<sup>17</sup> Further, prior ADB programs indicate that program effectiveness is enhanced when reforms begin with the basic building blocks and are backed by comprehensive TA. ADB's experience also indicates that the effectiveness of the reforms

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<sup>15</sup> Summary Sector Assessment (accessible from the list of linked documents in Appendix 2).

<sup>16</sup> Decision 219/QĐ-NHNN of 9 February 2012; the Human Resource Development Master Plan for the banking sector over 2011–2020.

<sup>17</sup> International Monetary Fund. 2003. Kracdag, Sundararajan, and Elliot. *Managing Risks in Financial Market Development: The Role of Sequencing*. Washington, DC.

should be fully demonstrated before introducing more complex reforms. Therefore, the FSDP will utilize a programmatic approach, with 2 subprograms to narrow and refocus a sustained effort to develop a money market and a capital market, emphasizing government debt as the basic building blocks of effective macroeconomic management and financial sector development. The FSDP will also support capacity development in recognition of the key role technical and management skills play in implementing reforms, maintaining stability, and fostering investor confidence.

## **B. Impact and Outcome**

16. The impact of the FSDP will be an expanded level of nonbank financing, which will be reflected, in part, through growth of local currency debt markets relative to GDP. The outcome will be strengthened investor confidence.

## **C. Outputs**

17. To achieve the envisioned impact and outcome, the proposed program is designed to support the government in bringing about the following outputs: (i) a well-functioning money market, (ii) a deeper and more liquid capital market, and (iii) strengthened capacity of public and private institutions in the nonbank financial sector. Subprogram 1 contains 32 policy actions, all of which have been completed. The design and monitoring framework is provided in Appendix 1 and the policy matrix in Appendix 4.<sup>18</sup>

18. **Output 1: A well-functioning money market.** To increase liquidity and accelerate the development of the interbank market, the SBV and MOF have significantly enhanced coordination and information exchange through the adoption of a comprehensive memorandum of understanding that covers, among other areas, the development and supervision of the money market. Within this framework, the SBV has established a Money Market Working Group (MMWG) to implement a Money Market Development Master Plan. The MMWG is headed by a deputy governor and is supported by a comprehensive terms of reference that governs the participation of a broad group of stakeholders.<sup>19</sup> Under this cooperative framework, the SBV and MOF have agreed to coordinate the issuance of short-term debt to eliminate overlapping maturities. The MMWG, through the SBV, has issued regulations governing loans secured by the mortgage of valuable papers and the discount and rediscount of valuable papers by the SBV. The MMWG has strengthened the code of conduct for the foreign exchange interbank market. Regulations covering brokerage activities have been improved. Preparations to introduce a formal repo market have begun, which will include initiatives to introduce netting to reduce systemic credit risk.

19. To increase transparency and price discovery, short-term government debt with a maturity of 1 year or less is now traded on HNX. The SBV is collating information on local currency interbank transactions and publishing basic transactional data on its external website. The SBV has further improved transparency by publishing basic data on monetary and banking operations and has strengthened bank liquidity standards.

20. **Output 2: A deeper and more liquid capital market.** To further develop the government debt market, thereby enhancing the private sector's access to nonbank finance, the

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<sup>18</sup> Contribution to the ADB Results Framework (accessible from the list of linked documents in Appendix 2).

<sup>19</sup> These stakeholders include the Monetary Policy Department, Credit Department, FX Department, Central Banking Department, Legal Department, and the Ministry of Finance.

MOF strengthened the legal framework governing the issuance and management of public debt. These guidelines contain measures to control and cap the level of sovereign guarantees. The MOF also provided an enhanced mechanism to issue government bonds, including auction timing and announcements. The MOF has continued its program of large-lot issuance to facilitate liquidity in the government bond market and has used switch auctions to reduce the number of outstanding issues from 185 in 2010 to 102 at the end of the first quarter of 2013. In addition, the MOF has taken measures to (i) increase liquidity and trading volumes in the secondary market; (ii) better protect investors by setting guidelines for trading accounts; and (iii) prescribing standards and prohibitions for margin, inter-day, and insider trading.

21. To provide comprehensive direction and measurable performance targets, the MOF finalized the bond market development road map. The MOF rationalized regulations governing the issuance of corporate bonds, streamlined administrative procedures, and increased the level of responsibility among potential issuers. In tandem, the MOF strengthened governance by issuing enhanced disclosure standards and by adopting the Association of Southeast Asian Nations (ASEAN) corporate governance scorecard.<sup>20</sup>

22. To strengthen the underlying financial market infrastructure, the MOF through the Insurance Supervisory Agency, completed a self-assessment of compliance with the Association of Insurance Supervisors Core Principles, while the SSC completed a self-assessment of the implementation of International Organization of Securities Commissions Core Principles. These self-assessments provided direct support to the recently completed FSAP. Both agencies developed action plans to improve compliance. MOF implemented the Law on Independent Audit by issuing decrees to strengthen the creation and organization of auditing enterprises. The decrees further established the necessity of audits and prescribed the content of audit reports and files. The SSC and Viet Nam Securities Depository improved customer service and reduced operational risk in the securities settlement process. These initiatives serve as a precursor to the eventual transfer of the cash settlement leg of government securities transactions to the SBV.

23. **Output 3: Strengthened capacity of public and private institutions in the nonbank financial sector.** To address the sector-wide capacity deficit, the SBV completed a human resources development plan covering the period 2011–2020. This plan recognizes the need to improve investor confidence through more effective supervision and regulation. It ensures the development of capacity not just within the SBV but also throughout the banking industry. It identified a wide range of necessary inputs covering academia to internal training programs. To address the sector's most pressing needs, the SBV is focusing initially on its core operations and identified several groups of 40–60 staff members for intensive training. A similar program is being launched for the banking sector which focuses, among others, on bank and risk management, research and development, information technology, credit administration, and internal audit and control. Concurrently, the SSC completed a plan for human resources development covering the medium-term period of 2011 to 2020. From 2011 to 2013, the SSC is focusing on improving the quality of its professionals. From 2014 to 2015, it will strengthen the structure, functions, duties, and powers of its organization.

24. To strengthen public disclosure in line with international practices, and to strengthen investor protections, the MOF completed a comprehensive assessment of gaps between Viet Nam Accounting Standards (VAS) and International Financial Reporting Standards (IFRS). An accounting and auditing strategy and road map has been adopted to strengthen the legal

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<sup>20</sup> ASEAN Corporate Governance Scorecard.

framework, improve the quality of the local industry and self-regulatory organizations, and foster greater international cooperation. Within the accounting and auditing strategy, the MOF has begun strengthening accounting and auditing standards, which will lead to the eventual recognition of market or fair value accounting. Likewise, the MOF, through the Insurance Supervisory Agency, has reviewed the amended Law on Insurance Business to identify gaps from international sound practice. This review is serving as a benchmark to begin the eventual implementation of Solvency 1 for the insurance sector.<sup>21</sup>

25. **Subprogram 2.** Recognizing the long-term nature of financial sector development and the unique and challenging nature of the Vietnamese market, subprogram 2 contains 45 indicative policy actions designed to build on the accomplishments of subprogram 1. The SBV and MOF will continue to coordinate to further deepen the short-term yield curve, and legislation will be proposed to introduce interest rate derivatives. New money market instruments, including the possible development of a standardized repurchase agreement, will be introduced. The MOF will implement the bond market development road map and will further strengthen the primary government issuance process. The government will align local standards to international standards by increasing compliance with the Association of Insurance Supervisors Core Principles and the International Organization of Securities Commissions Core Principles. The government will take steps to introduce fair value accounting. The SSC and SBV will implement their human resources development plans.

#### D. Development Financing Needs

26. In 2013, the government will need to borrow D162 trillion to cover a budget deficit targeted at 4.8% of GDP. In 2012, deficit financing was obtained from domestic sources (44%) and external sources (56%), of which some 84% was accounted for by official development assistance (ODA). Assuming a similar distribution for 2013, the government will borrow an estimated \$3.7 billion through ODA to close the budget gap. The size of the loan primarily reflects the government financing needs. Secondary considerations include the strength of the reform program and the costs of implementation.<sup>22</sup> For example, the government will absorb increased issuance costs with the ongoing extension of government maximum bond tenors to 15 years from 10 years. In addition, the transfer of the cash settlement leg of securities transactions to the SBV will encompass significant capital expenditures. Under the FSDP, training budgets in both the MOF and SBV will be increased significantly to provide for higher levels of technical expertise and larger staff numbers. The SSC alone has projected an increase in staff count to 1,000 by 2015 from the current level of 400. A recently completed comprehensive skills gap assessment indicates the SBV will require \$20 million for training costs over the program period.<sup>23</sup>

27. The government has requested a loan in various currencies equivalent to SDR29,238,000 from ADB's Special Funds resources to help finance subprogram 1. The loan will have a 25-year term, including a grace period of 5 years, an interest rate of 2.0% per annum during the grace period and thereafter, and such other terms and conditions set forth in the draft loan agreement. The proceeds of the policy-based loan will be disbursed in accordance with the provisions of ADB's Simplification of Disbursement Procedures and Related Requirements for Program Loans.<sup>24</sup> Subprogram 2, with an indicative amount of \$70 million, will be subject to

<sup>21</sup> Solvency 1 is the name given to changes to the EU's insurer solvency regime made in 2002. For more information see: <http://www.lloyds.com/the-market/operating-at-lloyds/solvency-ii/about/solvency-i>.

<sup>22</sup> ADB. 2011. *Policy-Based Lending. Operations Manual. OM D4/BP*. Manila (para. 32).

<sup>23</sup> Government of Viet Nam, State Bank of Viet Nam. 2013. *Skill Gap Assessment Report*. Ha Noi.

<sup>24</sup> ADB. 1998. *Simplification of Disbursement Procedures and Related Requirements for Program Loans*. Manila.

further discussion between ADB and the government as well as the availability of Asian Development Fund resources. Subprogram 2 will be submitted for Board approval upon completion of the indicative policy actions. The policy matrix given in Appendix 4 indicates the program framework, including the 32 policy actions completed prior to Board consideration for subprogram 1, and those proposed for subprogram 2.

## **E. Implementation Arrangements**

28. The FSDP comprises two single-tranche subprograms. Subprogram 1 covers July 2010 to August 2013. Subprogram 2 covers September 2013 to June 2015. To reduce compliance-based program implementation, emphasis will be placed on the achievement of tangible results. The executing agency for the FSDP will be the SBV; the implementing agencies will be the MOF, SSC, HNX, and SBV. The MMWG acts as a coordination mechanism for the implementation of the Money Market Development Master Plan, meeting biannually and providing a ready mechanism through which the government can bring various stakeholders together to implement reforms, which will become increasingly more challenging going forward.

## **III. DUE DILIGENCE**

### **A. Economic and Financial**

29. A growing body of empirical research produces a remarkably consistent narrative: the services provided by the financial system exert a first-order impact on long-run economic growth. Building on work by Bagehot (1873), Schumpeter (1912), Gurley and Shaw (1955), Goldsmith (1969), and McKinnon (1973), recent research has employed different econometric methodologies and data sets in producing three core results.<sup>25</sup> Levine and Zervos have quantified this cost.<sup>26</sup> Using panel data from 47 countries from 1976 through 1993, they demonstrated that stock market liquidity and banking development both positively predict economic growth, and that both together, as opposed to separately, provided a larger boost to real GDP per capita. Another study also indicated that contractual savings (e.g., insurance, mutual funds, and pensions) play a significant role in fostering economic development.<sup>27</sup> This same research indicates that the boost to economic growth achieved from increasing the penetration of life insurance is even more pronounced given higher levels of bank credit to GDP and stock market liquidity. In addition, a third study predicted that the positive impact of foreign direct investment on economic growth in Viet Nam will be larger if more resources are invested in financial market development.<sup>28</sup>

### **B. Governance**

30. Since 2008, ADB has supported efforts to strengthen governance by improving planning processes, strengthening public financial management and public administration, and improving legal transparency and accessibility.<sup>29</sup> Public financial management reforms are at an early stage, but steady progress is being made. For example, the government has adopted several

<sup>25</sup> J. Rosengard and H. Du. 2009. Funding Economic Development: A Comparative Study of Financial Sector Reform in Viet Nam and China. *UNDP–Harvard Policy Dialogue Papers*.

<sup>26</sup> R. Levine and S. Zervos. 1998. Stock Markets, Banks, and Economic Growth. *The American Economic Review*.

<sup>27</sup> M. Arena. 2008. Does Insurance Market Activity Promote Economic Growth? A Cross-Country Study for Industrialized and Developing Countries. *The Journal of Risk and Insurance*. 75 (4). pp. 921–946.

<sup>28</sup> Sajid Anwar and Lan Phi Nguyen. 2011. Financial Development and Economic Growth in Vietnam. *Journal of Economics and Finance*. 35 (3). pp. 348–360.

<sup>29</sup> ADB. 2008. *Report and Recommendation of the President to the Board of Directors: Proposed Program Loan for the Socialist Republic of Viet Nam for the Implementation of Poverty Reduction Program Cluster V*. Manila.



legal reforms, including the Anti-Corruption Law. Under the National External Debt and Public Debt Strategy, 2011–2020 aggregate public debt information has been published for the first time, but more needs to be done.<sup>30</sup> In spite of good tax collection ratios (approximately 26% of GDP), the determination of actual budget deficits is compromised by the application of standards different from the Global Financial Statistics in the government's official accounts. Further efficiency of budget allocations and service delivery requires better linkages between medium-term planning and budgeting and between capital and recurrent expenditures. The government is reviewing the 2002 Budget Law to deepen the implementation of the medium-term expenditure framework and performance-based budgeting, and to improve budget execution, monitoring, and implementation. The treasury and budget management information system is strengthening government budget reporting and accounting. Tax management and customs modernization reforms are underway, increasing the transparency of administrative procedures and reducing compliance costs for taxpayers. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government.

### C. Poverty and Social

31. The SEDS targets a 7%–8% annual economic growth rate, the creation of 8 million new jobs, and an average annual reduction in the number of poor households of 2%–3%. To accomplish these goals, the SEDS includes a focus on economic restructuring that is grounded, in part, on capacity and financial sector development. Under the FSDP, money market development will help the government better manage inflation through monetary interventions, while a deeper government bond market will anchor commercial issuance and provide the long-term funding to much needed infrastructure projects and social expenditures. The ongoing rationalization of debt management and issuance will complement these efforts, leading to lower financing costs and increased fiscal space that could be allocated to social development goals. The FSDP also complements subprogram 2 of the Second Small and Medium Enterprise Development Program, which will strengthen regulatory frameworks and enhance access to finance.<sup>31</sup>

32. Moreover, a number of empirical studies have supported the direct relationship between financial sector development and poverty reduction.<sup>32</sup> The link between economic growth and financial sector development is well known and has been empirically substantiated (para. 29). However, financial sector development also improves access to finance by reducing information and transaction costs. This allows more entrepreneurs, especially those less well-off, to obtain external finance. For these reasons, the poor will benefit from the FSDP because a deeper and more liquid finance sector will increase access to finance at a lower cost through a greater number and diversity of financial providers and financial products. Finally, financial sector development reduces financial instability, which is becoming more common in increasingly global markets, and which has been shown to have a disproportionate impact on the poor.

### D. Safeguards

33. The FSDP will not entail any involuntary resettlement or negatively affect indigenous people or the environment. It is assigned category C for all safeguards categories (involuntary resettlement, impact on indigenous people, and environmental impact).

<sup>30</sup> Government of Viet Nam. 2012. *National External Debt and Public Debt Strategy, 2011–2020*. Ha Noi.

<sup>31</sup> Summary Poverty Reduction and Social Strategy (accessible from the list of linked documents in Appendix 2).

<sup>32</sup> See for instance G. Jeanneney, S. Kpodar, and K. Kpodar. 2008. Financial Development and Poverty Reduction: Can there be a benefit without a cost? *International Monetary Fund Working Paper # 62*. Washington, DC.

## **E. Risks and Mitigating Measures**

34. As a policy-based loan, FSDP is exposed to broader national and macroeconomic risks and risks associated with public financial management and corruption. ADB is actively coordinating with other development partners to mitigate these risks through policy dialogue to support ongoing efforts to enhance macroeconomic stability. Annual debt sustainability assessments are being conducted to monitor macroeconomic vulnerabilities, and the ADB is providing technical assistance to strengthen both public financial management and debt management. Among other initiatives, ADB will mitigate corruption risks through policy dialogue, increased monitoring and support for select transparency initiatives. Program-specific risks include a possible decline in political will to implement technically difficult reforms, and protracted or inadequate efforts to advance SOE reform and bank recapitalization which could result in a loss of investor confidence. The policy goals of SEDS 2011–2020 and the recent completion of Viet Nam’s first FSAP provide evidence of the government’s commitment to reform. Under an ongoing project, ADB is supporting the restructuring of selected SOEs through a process which can be replicated.<sup>33</sup> In addition, the government has taken steps to address banking sector vulnerabilities by establishing an asset management company, resolution strategies, and authorizing higher levels of foreign ownership. Specific risks and corresponding mitigating measures are described in detail in the risk assessment and risk management plan.<sup>34</sup>

## **IV. ASSURANCES**

35. The government and the SBV have assured ADB that implementation of the program shall conform to all applicable ADB policies, including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement as described in detail in the project administration manual and loan documents.

## **V. RECOMMENDATION**

36. I am satisfied that the proposed programmatic approach and policy-based loan would comply with the Articles of Agreement of the Asian Development Bank and recommend that the Board approve

- (i) the programmatic approach for the Financial Sector Deepening Program, and
- (ii) the loan in various currencies equivalent to SDR29,238,000 to the Socialist Republic of Viet Nam for subprogram 1 of the Financial Sector Deepening Program, from ADB’s Special Funds resources, with an interest charge at the rate of 2% per annum during the grace period and thereafter; for a term of 25 years, including a grace period of 5 years, and such other terms and conditions as are substantially in accordance with those set forth in the draft loan agreement presented to the Board.

Takehiko Nakao  
President

12 November 2013

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<sup>33</sup> ADB. 2009. Report and Recommendation of the President to the Board of Directors: Proposed MFF to the Socialist Republic of Viet Nam for the State-Owned Enterprise Reform and Corporate Governance Facilitation Program. Manila.

<sup>34</sup> Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

## DESIGN AND MONITORING FRAMEWORK

| Design Summary  | Performance Targets and Indicators with Baselines   | Data Sources and Reporting Mechanisms  | Assumptions and Risks  |
|---|---|--|--|
| <p><b>Impact</b><br/>An expanded level of nonbank financing</p> | <p>Market capitalization of the combined stock exchanges increases to 35% of GDP by 2018.<br/><br/>(Baseline = 19% in 2010)</p> <p>Total local currency bonds outstanding increases to 25% of GDP by 2018 to meet target of 38% in 2020.<sup>a</sup><br/><br/>(Baseline = 16% in 2010)</p>                            | <p>SSC</p> <p>MOF</p>  | <p><b>Assumptions</b><br/>Increase in the size of local currency debt markets translates into sustained financing of productive public and private capital expenditures.</p> <p><b>Risks</b><br/>The government fails to adopt and implement a sound macroeconomic management framework.</p>   |
| <p><b>Outcome</b><br/>Strengthened investor confidence</p>      | <p>Rank and score of Pillar 6, Financial Markets, improves by 2015.<sup>b</sup><br/><br/>(Baseline = 50/1.4 in 2010)</p>  | <p>World Economic Forum Financial Development Report</p>   | <p><b>Assumptions</b><br/>Global economic conditions remain favorable for business expansion and capital flows.</p> <p><b>Risks</b><br/>Political will for financial sector reforms declines over time.</p> <p>Government does not address SOE reform and bank recapitalization in a timely manner, resulting in a loss of investor confidence.</p>                                |
| <p><b>Outputs</b><br/>1. A well-functioning money market</p>    | <p>Increase in available tenors of treasury bills and/or SBV bills and/or repurchase agreements by 2015.<br/><br/>(Baseline = 182 days and 364 days in 2010)</p> <p>Global Master Repurchase Agreement adopted and launched by 2015.<br/><br/>(Baseline = 0)</p> <p>Aggregate quarterly turnover in the interbank</p> | <p>SBV website<br/>Market surveys</p> <p>SBV website<br/>Consultant reports</p> <p>SBV website<br/>Reuters</p> | <p><b>Assumptions</b><br/>Inter-related policy reforms are implemented in line with international sound practices.</p> <p><b>Risks</b><br/>Coordination between the SBV and MOF is not adequate, resulting in conflicting application of policy and disruptions in the bond market.</p> <p>Adequate funding is not provided to support sustained capacity development efforts.</p> |

| Design Summary  | Performance Targets and Indicators with Baselines   | Data Sources and Reporting Mechanisms   | Assumptions and Risks   |
|---|---|---|---|
|   | <p>market increased by 2015.</p> <p>(Baseline = D1,244 trillion in the third quarter of 2010)</p>   | Market surveys  | <p>Supply and demand for interbank borrowing is adversely affected by external factors.</p>               |
| 2. A deeper and more liquid capital market  | <p>Volume of government bonds held by contractual savings sector increases to 16% by 2015.<sup>a</sup></p> <p>(Baseline = 11% in 2010)</p> <p>Average tenor of government bonds (excluding treasury bills) increases to 4–6 years by 2015.<sup>a</sup></p> <p>(Baseline = 3.8 years in 2010)</p> <p>Increase in bond trading volume to 0.25% of outstanding listed bonds by 2015.<sup>a</sup></p> <p>(Baseline = 0.2% in 2010)</p> <p>Aggregate value of stock traded on HNX and HOSE increases by 15% by 2015.</p> <p>(Baseline = D180 trillion in 2010)</p> | <p>MOF</p> <p>MOF website<br/>AsianBondsOnline</p> <p>MOF website<br/>AsianBondsOnline</p> <p>HOSE and HNX website</p>  | <p>The legal framework contains significant impediments that would delay or prevent adoption of GMRA.</p> |
| 3. Capacity of public and private institutions in the nonbank financial sector improved | <p>VAS more than 50% aligned to IAS by 2015.</p> <p>(Baseline = 0)</p> <p>At least 50% of the ISA supervision staff trained on examination and inspection by 2015.</p> <p>Comprehensive skills gap assessment completed by 2015.</p> <p>Capacity development under the medium-term training plan 50%</p>  | <p>Consultant reports<br/>MOF website</p> <p>Consultant reports<br/>MOF website</p> <p>SBV Human Resources Department</p> <p>SBV Human Resources Department</p> |   |

| Design Summary  | Performance Targets and Indicators with Baselines | Data Sources and Reporting Mechanisms | Assumptions and Risks  |
|---|---|---------------------------------------|--|
|   | completed by 2015.                                |                                       |  |
| <b>Activities with Milestones (Overall Project)</b> <ol style="list-style-type: none"> <li><b>1. A well-functioning money market</b> <ol style="list-style-type: none"> <li>1.1 SBV establishes the MMWG (November 2011).</li> <li>1.2 SBV discloses the direction of monetary policy and banking operations (March 2013).</li> <li>1.3 SBV proposes increased sanctions for noncompliance with its revised bank liquidity standards (June 2013).</li> <li>1.4 MOF and SBV to further develop the primary and secondary markets (September 2014).</li> <li>1.5 SBV initiates a review of the Law on Negotiable Instruments (September 2014).</li> </ol> </li> <li><b>2. A deeper and more liquid capital market</b> <ol style="list-style-type: none"> <li>2.1 MOF launches trading of government bonds on HNX (September 2013).</li> <li>2.2 MOF launches regular, published action schedule (December 2013).</li> <li>2.3 MOF further improves the link between cash management and government bond issuance (December 2014).</li> <li>2.4 MOF to provide a legal framework for the deposit insurance system to purchase government bonds (December 2014).</li> <li>2.5 MOF supports formation of government bond yield curve (February 2013).</li> <li>2.6 MOF to initiate introduction of market makers for government debt (December 2014).</li> <li>2.7 MOF to discontinue direct placement of government debt into contractual savings (June 2015).</li> </ol> </li> <li><b>3. Capacity of public and private institutions in the nonbank financial sector improved</b> <ol style="list-style-type: none"> <li>3.1 SBV to complete skills gap assessments of key operational areas (September 2013).</li> <li>3.2 SSC proposes appropriate budget allocation and supplementary donor funding to support the human resources development plan (September 2014).</li> <li>3.3 MOF to complete an outline of the amended accounting law to incorporate fair value (August 2014).</li> </ol> </li> </ol> |   |                                       | <b>Inputs</b><br><br><b>ADB</b><br>Asian Development Bank (Asian Development Fund): \$45 million |

GDP = gross domestic product, GMRA = Global Master Repurchase Agreement, HOSE = Ho Chi Minh Stock Exchange, HNX = Ha Noi Stock Exchange, IAS = International Accounting Standards, ISA = Insurance Supervisory Agency, MMD-MP = Money Market Development Master Plan, MMWG = Money Market Working Group, MOF = Ministry of Finance, SBV = State Bank of Viet Nam, SSC = State Securities Commission, VAS = Viet Nam Accounting Standards.

<sup>a</sup> These performance targets are extrapolated midpoints from MOF's targets, which cover the period 2011–2020. The source is ADB. MOF's bond market development targets represent performance goals but are not considered firm commitments of the government.

<sup>b</sup> This pillar captures foreign exchange and derivatives markets, as well as and equity and bond market development.

Source: Asian Development Bank.

### **LIST OF LINKED DOCUMENTS**

<http://adb.org/Documents/RRPs/?id=44251-013-3>

1. Loan Agreement
2. Sector Assessment (Summary): Finance
3. Contribution to the ADB Results Framework
4. Development Coordination
5. Country Economic Indicators
6. International Monetary Fund Assessment Letter
7. Summary Poverty Reduction and Social Strategy
8. Risk Assessment and Risk Management Plan
9. List of Ineligible Items

### **Supplementary Document**

10. Macroeconomic Assessment and Debt Sustainability Assessment



# STATE BANK OF VIETNAM

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## DEVELOPMENT POLICY LETTER

State Bank of Vietnam  
47-49 Ly Thai To Str,  
Hoan Kiem District, Hanoi

### Letter of Development Policy from the Socialist Republic of Vietnam Financial Sector Deepening Program

Dear Mr. President,

1. We would like to express our appreciation for the continuing support of the Asian Development Bank and your own keen interest in the promotion of more resilient regional markets, including those in Vietnam. We recognize that a possible sharper-than-anticipated slowdown in Asian economies in response to a weakened European economy, or the withdrawal of stimulus in the United States, may continue to influence Vietnam's financial sector over the coming years. To this end, we recognize government policies need to credibly prioritize stability and address weaknesses in the financial sector.

2. Viet Nam has achieved rapid economic growth over the past two decades by continuously implementing market-oriented reforms. With the average annual growth rates of 6.2% from 2007 to 2011 and 5.3% in 2012, Viet Nam's gross domestic product per capita rose from \$919 in 2007 to \$1,749 in 2012. The country is now classified as a lower middle-income country. Its development has benefited from political and social stability. Viet Nam has weathered global macroeconomic instability well, posting an average growth rate higher than regional comparator countries. Viet Nam has also addressed the symptoms of macroeconomic problems by tightening monetary and fiscal policies, lowering inflation from a peak of 23% in August 2011 to single digits from May 2012 to the end of first half of 2013. While the process has been effective, the government acknowledges that the growth impetus unleashed by early reforms is losing some momentum, requiring that reforms deepen and accelerate.

3. To provide a renewed momentum for reform, Vietnam's Socio-Economic Development Strategy 2011–2020 (SEDS) establishes a roadmap to transform Vietnam into a modernity-oriented industrial country with a per capita income level of US\$3,000 (in current U.S. dollars) by 2020. The Socio-Economic Development Strategy also identifies the country's key priorities to meet this ambitious target: stabilize the economy, build world-class infrastructure, create a skilled labor force, and strengthen market-based institutions. Within the Socio-Economic Development Plan, the initiatives of the first of two 5-year plans, which covers 2011-2015, requires our urgent attention. These goals include the restructuring the economy together with renovating growth model towards high quality, efficiency and competitiveness, focus on restructuring the economy in three important fields: investment, especially public investment; financial market, especially commercial banking system and financial institutions; and enterprises, in particular economic groups, and state-owned corporations. A strategic focus and

specific actions are recommended for each sector while crosscutting issues center on strong reform and good governance.

4. In recognition of the challenges ahead, ADB's Country Partnership Strategy (CPS 2012-2015) establishes and defines our mutual commitment to supporting inclusive growth, enhancing economic efficiency, and providing for environmental sustainability. We appreciate that the finance sector is among the six priority sectors as the Government recognizes that financial sector development is essential in ensuring private sector led growth and economic development. Entering the second decade of 21<sup>st</sup> century, Viet Nam is at a critical juncture and needs to sustain its development progress to ensure that it can move to a higher income status and continue to reduce poverty. Compared to low-income developing countries on the one hand, and high-income developed countries on the other, middle-income emerging market economies are the most vulnerable to financial crises and instability. Continuous financial sector reforms are therefore viewed as essential, as Viet Nam is migrating towards a higher middle income status and a more productive, innovative, and mature market-based economy

5. Therefore, on behalf of the Government, I would first like to reconfirm Vietnam's continuing commitment to reforming the financial sector. As a visible demonstration of this commitment, Vietnam recently welcomed the completion of its first Financial Sector Assessment Program (FSAP) by the International Monetary Fund and World Bank. This purpose of the FSAP was to assess the current condition of the broad financial sector and its supporting infrastructure, and to identify vulnerabilities and priority reforms. As expected, the FSAP confirmed our existing concerns regarding the state owned enterprises and the need to recapitalize the banking system. However, the FSAP also provided strong recommendations to Vietnam to expand and further deepen the financial sector as an alternative to the bank dominated economy. Bond and insurance markets have been established but they remain relatively small. In particular, the Government will focus on improving the confidence of investors, consumers, and the general public to ensure that potential investors, both domestic and offshore, are reassured about the stability of the market and the regulatory environment into which their investments will be placed.

6. Foremost, the government recognizes that vibrant and liquid money markets are vital funding mechanisms for financial institutions and are a crucial component of the financial system. Money markets contribute to market efficiency and discipline and to the stability of the economy at large as they are used as a transmission mechanism for monetary policy. In this context the Money Market Development Master Plan was issued in August 2010. A Money Market Development Working Group has been established tasked to coordinate and further strengthen the cooperation and exchange of information for the effective implementation the Master Plan.

7. Under the Master Plan, SBV will review, amend and supplement regulations on money market operations, including: Circular guiding money brokerage activities; regulations on derivatives, inter-bank foreign exchange market. In addition, SBV will coordinate with MOF to support the development of a yield curve. SBV will also begin transforming trade associations into self-regulatory organizations. Over the medium to long-term, the Government, through SBV will attempt to solve some of the more challenging issues such as SBV's independence and legal mandate. Responsibilities such as providing and enforcing a code of conduct, adopting uniform price quotation methods, and facilitating the resolution of disputes will be delegated to the associations as SRO's. Finally, SBV will provide incentives to market participants to develop and improve risk management systems, the quality of management, and staff training.



the foreign exchange inter-bank market. Regulations covering brokerage activities have been amended and requirements to deposit netting for interbank market obligations will be identified to reduce credit risk. Prudential regulations covering the liquidity management practices of credit institutions have been substantially upgraded. Moreover, the Government is in the process of identifying and resolving the impediments to introducing the Global Master Repurchase Agreement to Vietnam as a precursor to formally adopting the instrument.

13. Concurrently, the Ministry of Finance has strengthened the issuance and management of public debt and has refined its mechanism to issue government bonds, including auction timing and announcements, mechanisms for issuing government bonds, and the allowable uses and levels of sovereign guarantees. To support the development of the domestic corporate bond market, MOF rationalized and streamlined regulations governing issuance and administrative procedures, while at the same time increasing the responsibility and accountability of the issuers. More broadly, MOF has strengthened the standards for information disclosure and transparency in the securities market. MOF has implemented the Law on Independent Audit by drafting decrees to strengthen the accounting and auditing industry. MOF, through SSC has strengthened corporate governance standards of publically listed companies by adopting the ASEAN Corporate Governance scorecard. At the same time, the Hanoi Stock Exchange strengthened its own internal corporate governance by issuing and implementing a code of conduct for staff.

14. Under Subprogram 1, we have also initiated efforts to strengthen the capacity of public institutions so that we may achieve the full benefit of our ongoing structural reforms. The State Bank and Ministry of Finance have both completed human resource development (training) plans covering the period 2011-2020. Additional, more comprehensive skills gap assessments are planned to identify high priority training needs. The Ministry of Finance has initiated a program to build expertise and in time, to publish an in-house debt sustainability analysis. More significantly, the Government has recognized the need to introduce market value into Vietnam Accounting Standards to provide the appropriate incentives for the next step of financial market reforms. As a first step, the Ministry of Finance has completed a full gap assessment of International Accounting Standards as compared to Vietnam Accounting Standards to support eventual alignment of the two, including the introduction of market value.

15. These actions have already begun to produce positive results. The State Bank of Vietnam and the Ministry of Finance are coordinating their activities to deepen the short-term yield curve. The State bank is issuing shorter tenors while the Ministry of Finance is issuing 1-year treasury bills which are now traded on the Hanoi Stock Exchange. Likewise, total local currency bonds outstanding grew 42.7% year-on-year to reach VND521 trillion (USD25 billion) as of end-December 2012. This represents an accelerated expansion from 2011 wherein total local currency bonds outstanding grew 16.5% year-on-year. Overall, the size of the local currency bond market has doubled over the last six years, rising to 20% of Gross Domestic Product as of 31 March 2013.

16. To ensure the momentum for reform is not diminished by these recent achievements, the Government is committed to an ongoing medium-term policy reform program within FSDP to be implemented over the period September 2013 to June 2015. The Government and ADB will jointly engage in an ongoing policy dialogue to better refine Subprogram 2 to ensure the continuing development of the money market, the bond market as well as related financial market infrastructure. The Government also stands committed to take necessary steps during and beyond the program period to support on-going monitoring of progress through a review of the relevant outputs and outcome indicators.

17. To support these reforms, the Government has requested a policy based program loan cluster to be delivered in 2 subprograms as follows; \$45 million for subprogram 1. Vietnam's Gross Domestic Product (GDP) growth is forecast to reach 5.5 percent in 2013 according to Resolution No. 31/2012/QH13 of the National Assembly regarding Socio-Economic Development Plan for the year 2013 and 6 percent in 2014 according to Directive No 13/CT-TTg of the Prime Minister of the Government dated 25 June 2013 regarding building Socio-Economic Development Plan and state budget estimates for 2014. The loan amount is based on the financing needs of the government, the strengths of the policy package, and its development impact. Viet Nam's gross financing needs remain high. In 2013, with a budget deficit target of 4.8%, the government will need to borrow VND 162 trillion (\$7.8 billion). In 2012, deficit financing was obtained from domestic sources (44%) and external sources (56%), of which some 84% was accounted for by ODA. Assuming a similar distribution for 2013, the government will borrow an estimated \$3.7 billion through Official Development Assistance to close the budget gap.

18. In conclusion, the Government of Vietnam acknowledges and appreciates ADB's efforts to support our initiatives to introduce a more modern and market-based financial sector. We further appreciate ADB's commitment to work with the Government over the medium-term in further deepening and reforming the financial sector. We thus request favorable consideration of the proposed \$45 million subprogram 1 of FSDP. We would also like to provide our assurances that the Government will follow up these reforms under subprogram 2 of FSDP and the ensuing post program partnership framework.

19. Let me, Mr. President, once again thank you for your support and express the hope that the Financial Sector Deepening Program will be considered favorably by the ADB Board at an early date.

Hanoi, 3<sup>rd</sup> October 2013 *Vh*



**Nguyễn Văn Bình**



**POLICY MATRIX**  
**Financial Sector Deepening Program**

| <b>No.</b>   | <b>Policy Actions</b>   | <b>Indicative Policy Actions</b>  |
|--|---|---|
|  | <b>Subprogram 1 (FSDP-SP 1)<br/>July 2010 to August 2013</b>  | <b>Subprogram 2 (FSDP-SP 2)<br/>September 2013 to June 2015</b>                       |
| <b>Output 1 - A Well-functioning Money Market.</b> |   |   |
| <b>1.1</b>   | <b>Coordinated execution of the money market development master plan achieved.</b>  |   |
| 1.1.1  | <p>MOF and SBV to enhance coordination and cooperation, among others in the development and supervision of the money market through a formal agreement on working cooperation and information exchange.</p> <p>Status: Completed</p>  | <i>MOF and SBV to continue to deepen cooperation.</i>                                 |
| 1.1.2  | <p>SBV to establish a Money Market Working Group (MMWG), supported by a comprehensive Terms of Reference (TOR), headed by a Deputy Governor, and comprising senior officials from Monetary Policy Department, Credit Department, FX Department, Central Banking Department, Legal Department and Ministry of Finance.</p> <p>MMWG to implement the tasks specified in article number 3 of the TOR.</p> <p>Status: Completed</p> | <i>MMWG continue to implement the tasks assigned in the TOR.</i>                      |
|  | MMWG completes implementation of initial activities under MMD-MP as follows:  | <i>MMWG completes implementation of principal activities under MMD-MP as follows:</i> |

| <b>No.</b> | <b>Policy Actions</b>  | <b>Indicative Policy Actions</b>   |
|------------|--|--|
| 1.1.3      | <p><b>Subprogram 1 (FSDP-SP 1)</b><br/><b>July 2010 to August 2013</b></p> <p>(i) MMWG, through SBV to review regulations governing the foreign exchange market to supplement the code of conduct for the FX interbank market.</p> <p>Status: Completed</p>  | <p><b>Subprogram 2 (FSDP-SP 2)</b><br/><b>September 2013 to June 2015</b></p> <p><i>MMWG, through SBV amends the regulations governing the foreign exchange market to supplement the code of conduct in the FX interbank market.</i></p> |
|            | <p>(ii) SBV, through MMWG reduces risk in the inter-bank market and provides a framework for the negotiation of valuable papers, including repurchase contracts, between credit institutions.</p>  | <p><i>SBV, through MMWG continues to encourage the development of a inter-bank money market.</i></p>   |
|            | <p>(iii)</p>   | <p><i>SBV, through MMWG considers the introduction of new money market instruments.</i></p>  |
|            | <p>(iv) MMWG to review regulations on brokerage activities to replace Decision 351/2004/QD-NHNN.</p> <p>Status: Completed</p>  | <p><i>MMWG to issue circular on brokerage activities to replace Decision 351/2004/QD-NHNN.</i></p>   |
|            | <p>(v)</p>   | <p><i>MMWG, through SBV identifies requirements to introduce deposit netting for interbank market obligations to reduce systemic credit risk based on ADB TA findings in support of policy action 1.1.4.</i></p>                         |
|            | <p>(vi)</p>  | <p><i>MMWG, through SBV to revise the regulations governing the FX market in the direction that further foreign exchange hedging instruments will be applied to enhance the liquidity of the domestic market.</i></p>                    |
|            | <p>(vii) SBV and MOF coordinate to deepen the short term yield curve;</p> <ul style="list-style-type: none"> <li>• SBV and MOF coordinate issuance of short term debt.</li> <li>• MOF requires short term government debt with maturity of one year or less to be traded on HNX.</li> </ul> <p>Status: Completed</p> | <p><i>SBV and MOF continue to coordinate to further deepen the short-term yield by further developing the primary and secondary markets.</i></p>   |

| No.   | Policy Actions   | Indicative Policy Actions  |
|-------|--|--|
| 1.1.3 | (viii) SBV to collate accurate information on domestic currency interbank transactions and enhance dissemination of information on its external website.<br><br>Status: Completed  | <i>SBV to monitor and enhance the dissemination of domestic currency interbank transactions on its external website within 24hrs.</i>  |
|       | (ix)   | <i>SBV, through MMWG proposes legislation to provide interest rate derivatives.</i>  |
|       | (x) MMWG, through SBV issues regulations through the Governor on loans secured by the mortgage of valuable papers, discount and rediscount by the SBV, to increase liquidity and stimulate the development of the interbank market.<br><br>Status: Completed |  |
| 1.1.4 |  | <b><i>SBV, through MMWG identifies impediments to introducing the Global Master Repurchase Agreement (GMRA) to Vietnam.</i></b><br><br><b><i>As possible, given identified impediments, SBV through MMWG drafts and adopts the GMRA with Viet Nam annexes.</i></b><br><br><b><i>MOF in cooperation with SBV, through MMWG reviews and amends regulations governing the accounting and taxation of repurchase transactions to facilitate and encourage use of the GMRA.</i></b> |
| 1.2   | <b><i>Legal and operational framework for the money market strengthened.</i></b>   |  |
| 1.2.1 |  | <i>SBV through MMWG to improve monitoring through extraction and collation of information on foreign currency transactions in the interbank market.</i>  |

| No.   | Policy Actions   | Indicative Policy Actions  |
|---|--|--|
|   | <b>Subprogram 1 (FSDP-SP 1)<br/>July 2010 to August 2013</b>   | <b>Subprogram 2 (FSDP-SP 2)<br/>September 2013 to June 2015</b>  |
| 1.2.2   | SBV to improve transparency by issuing a regulation on publishing the SBV's direction on monetary and banking operations.<br><br>Status: Completed   | <i>Review Circular 35/2011/TT-NHNN to further improve disclosure and transparency.</i>   |
| 1.2.3   |  | <i>SBV to improve the legal framework to strengthen supervisory oversight covering bank liquidity standards.</i>   |
| 1.2.4   | SBV to issue legal documents to implement the SBV Law and the Law on Credit institutions.<br><br>Status: Completed   | <b><i>SBV to continue issuing legal documents to implement the SBV law and Law on Credit Institutions.</i></b><br><br><b><i>SBV to review the Law on Negotiable Instruments.</i></b> |
| <b>Output 2 - A Deeper and More Liquid Capital Market</b> |  |  |
| <b>2.1</b>  | <b><i>Enabling environment established.</i></b>  |  |
| 2.1.1   | Government to establish and strengthen the legal framework governing the issuance and management of public debt, including guidelines for reporting and disclosure of outstanding public debt, and the allowable uses and levels of sovereign guarantees.<br><br>Status: Completed | <i>Government reviews compliance with, and effectiveness of all legal instruments issued under Subprogram 1 governing the issuance of government debt.</i>                           |
| 2.1.2   | MOF finalizes the bond market development road map.<br><br>Status: Completed   | <i>MOF to implement the bond market development road map.</i>  |
| 2.1.3   | MOF to encourage the issuance of corporate debt by rationalizing the regulations on issuance of corporate bond and guidelines on authority approving bond issuance plans in order to streamline the administrative procedures,   | <i>MOF implements Decree 90/2011/ND-CP on issuance of corporate debt and reviews the effectiveness of the decree based on the size and volumes of corporate debt issued.</i>         |

| <b>No.</b> | <b>Policy Actions</b>   | <b>Indicative Policy Actions</b>  |
|------------|---|---|
|            | <b>Subprogram 1 (FSDP-SP 1)</b><br><b>July 2010 to August 2013</b>  | <b>Subprogram 2 (FSDP-SP 2)</b><br><b>September 2013 to June 2015</b>   |
| 2.1.4      | increase autonomy, establish self-responsibility rights of corporates.<br><br>Status: Completed   |   |
| 2.1.5      | MOF tightens the information disclosure regime, including the reporting requirements before and after the issuance of corporate bonds to protect the interests of the investors in the market.<br><br>Status: Completed | <i>MOF continues to tighten information disclosure, monitors compliance with Decree 90/2011/ND-CP and issues sanctions for non-compliance.</i>  |
| <b>2.2</b> | <b><i>Development of a risk-free yield curve.</i></b>   |   |
| 2.2.1      | MOF to provide a mechanism to issue government bonds including auction timing and announcements, mechanisms for issuing government bonds and establishing a primary dealer system<br><br>Status: Completed              | <i>MOF to continue strengthening the primary issuance process in line with Circular 17/2012/TT-BTC of 8 Feb 2012 by;</i><br><i>(i) Enhancing the operations of the primary dealer system by establishing the rights and obligations of primary dealers</i><br><i>(ii) Encouraging competition between primary dealers by establishing and operating an annual review process.</i> |
| 2.2.2      | MOF to continue large-lot size issuance to facilitate liquidity in the bond market<br><br>MOF to issue circular on switch auctions of Government bonds to facilitate consolidation of outstanding issues                | <i>MOF to continue large-lot size issuance to facilitate liquidity in the bond market.</i><br><br><i>MOF to consider issuance of longer-tenor government securities.</i>  |



| No.        | Policy Actions   | Indicative Policy Actions  |
|------------|--|--|
|            | <b>Subprogram 1 (FSDP-SP 1)</b><br><b>July 2010 to August 2013</b>   | <b>Subprogram 2 (FSDP-SP 2)</b><br><b>September 2013 to June 2015</b>  |
|            | Status: Completed  |  |
| <b>2.3</b> | <b><i>Information disclosure and transparency increased.</i></b>   |  |
| 2.3.1      | MOF to strengthen the standards for information disclosure to maintain transparency in the securities market.<br><br>Status: Completed   | <i>MOF to monitor information disclosures under Circular 52/2012/TT-BTC and evaluate the effectiveness of the framework.</i>                 |
| 2.3.2      | <b>MOF, through SSC strengthens corporate governance standards of publically listed companies by;</b> <ul style="list-style-type: none"> <li>• Issuing regulations on corporate governance, applicable for public companies, which reflect OECD standards including the introduction of independent directors and enhanced disclosures to address conflict of interests.</li> <li>• Organizing a public dissemination for publically listed companies to introduce the ASEAN Corporate Governance scorecard.</li> </ul> <b>Status: Completed</b> | <b><i>MOF, through SSC publishes corporate governance rankings of publically listed companies by group using the ASEAN CG Scorecard.</i></b> |
| 2.3.3      | SSC to launch a disclosure and outreach protocol for web-based disclosure of publicly listed companies.<br><br>Status: Completed   | <i>SSC to use the website to disclose all violations and sanctions.</i>  |
| <b>2.4</b> | <b><i>Legal, supervisory, and regulatory environment improved</i></b>  |  |
| 2.4.1      | MOF to implement the Law on Independent Audit (LIA) by drafting decrees to strengthen the accounting and auditing industry by providing guidelines covering the creation and   | <b><i>MOF adopts a Decree and implementing circular covering administrative sanctions for violations of the LIA</i></b>                      |

| <b>No.</b> | <b>Policy Actions</b>  | <b>Indicative Policy Actions</b>   |
|------------|--|--|
|            | <p><b>Subprogram 1 (FSDP-SP 1)</b><br/><b>July 2010 to August 2013</b></p> <p>organization of auditing enterprises, the provision of cross-border auditing services, the necessity of audits, report content and audit files.</p> <p>Upon approval, MOF to implement the decree's by issuing appropriate circulars.</p> <p>Status: Completed</p> | <p><b>Subprogram 2 (FSDP-SP 2)</b><br/><b>September 2013 to June 2015</b></p>  |
| 2.4.2      | <p><b>HNX initiates efforts to strengthen internal corporate governance by issuing and implementing a code of conduct for staff.</b></p> <p>Status: Completed</p>  | <p><i>HNX monitors and ensures continuing compliance with the code of conduct" which is reflected through the Code of ethics and professional conduct enclosed with Decision no 91/QD-HĐQT dated 31/7/2012 of HNX.</i></p>   |
| 2.4.3      | <p><b>SSC undertakes a self-assessment of the implementation of IOSCO principles.</b></p> <p>Status: Completed</p>   | <p><i>SSC to develop an action plan to address issues identified in the assessment based on the IOSCO principles in line with the Securities Market Strategy 2011-2020.</i></p>  |
| 2.4.4      | <p>SSC to strengthen its enforcement capacity by drafting decrees to implement the revised Securities Law, including provisions for sanctions;</p> <p>Status: Completed</p>  | <p><i>MOF implements the Decree on approval.</i></p>   |
| <b>2.5</b> | <b><i>Financial system stability and efficiency strengthened.</i></b>  |  |
| 2.5.1      | <p>SSC and VSD to revise existing regulations to improve customer service and to reduce operational risk in the securities settlement process by reducing settlement times.</p>  | <p><b><i>MOF, through SSC, and VSD to study the suitability of converting to and/or establishing a CCP.</i></b></p> <p><b><i>MOF, through SSC (and VSD), and SBV to study ways to transfer the cash settlement function for government bonds to SBV in accordance with the Prime Minister's Directive No 08/CT-TTg dated 2 March 2012.</i></b></p> |

| No.   | Policy Actions  | Indicative Policy Actions  |
|---|---|--|
|   | <b>Subprogram 1 (FSDP-SP 1)</b><br><b>July 2010 to August 2013</b>  | <b>Subprogram 2 (FSDP-SP 2)</b><br><b>September 2013 to June 2015</b>  |
| 2.5.2   | <b>To strengthen the supervisory framework, MOF, through ISA, completes a self-assessment of compliance with the Association of Insurance Supervisors (IAIS) Core Principles.</b><br><br>Status: Completed  | <b>SSC and VSD formalize securities borrowing and lending through issuance of appropriate guidelines.</b><br><br><i>ISA initiates corrective action to address areas of non-compliance in accordance with the roadmap.</i> |
| 2.5.3   | MOF, through ISA, to establish a comprehensive roadmap to develop the insurance market in Vietnam by enhancing risk management, diversifying products and distribution channels, and promoting international cooperation and integration.<br><br>Status: Completed                          | <i>MOF to study the pre-conditions for and viability of applying Solvency 1 in Viet Nam.</i>   |
| 2.5.4   | <b>MOF, through ISA, to implement Articles 28 and 37 which provide for a fund for the protection of insured persons under decree 123/2011/ND-CP.</b><br><br><b>MOF to provide guidance and management to establish the fund for protection of insured persons.</b><br><br>Status: Completed | <i>MOF through ISA to implement Circular 101.</i>  |
| 2.5.5   |   | <i>MOF, through SSC to develop an action plan to merge HNX and HOSE as mandated in the Securities Market Strategy 2011-2020.</i>   |
| <b>Output 3 - Capacity of Public and Private Institutions in the Non-Bank Financial Sector Improved</b> |   |  |

| No. | Policy Actions  | Indicative Policy Actions  |
|-----|---|--|
| 3.1 | <p><b>Subprogram 1 (FSDP-SP 1)</b><br/><b>July 2010 to August 2013</b></p> <p><b>MOF to begin to develop capacity leading to the initiation of an in-house debt sustainability analysis by (DSA).</b></p> <p>Status: Completed</p>  | <p><b>Subprogram 2 (FSDP-SP 2)</b><br/><b>September 2013 to June 2015</b></p> <p><i>MOF to continue building capacity on in-house debt sustainability analysis.</i></p>  |
| 3.2 | <p>MOF, through ISA to review the amended Law on Insurance Business to identify gaps from international sound practice.</p> <p>Status: Completed</p>  | <p><i>MOF, through ISA to improve legal framework to close gap from international sound practice.</i></p>  |
| 3.3 | <p>To strengthen public disclosures in line with international practices, MOF will adopt an accounting and auditing strategy and roadmap to strengthen the legal framework, revise and adopt appropriate accounting and auditing standards, improve the quality of the local industry and self-regulatory organizations, and foster greater international cooperation.</p> <p>Status: Completed</p> | <p><b><i>Under the accounting and auditing strategy and roadmap (Prime Ministers Decision #480), MOF will begin the alignment of VAS to IAS and IFRS as follows:</i></b></p> <p><b><i>(i) MOF will submit to the Government a proposal for amending the accounting law to facilitate the introduction of fair value into VAS consistent with IAS 32, IAS 39, and IFRS 7;</i></b></p> <p><b><i>(ii) Upon approval by the Government, MOF will establish a drafting committee for amending the accounting law in line with (i) above, and</i></b></p> <p><b><i>(iii) MOF will prepare an outline of the proposed amendment of the accounting law and circulate within the drafting committee for comments and subsequent approval of the Vice Minister, Finance.</i></b></p> |
| 3.4 | <p><b>SSC to develop a plan for human resources development over the medium-term period of 3-5 years.</b></p> <p>Status: Completed</p>  | <p><i>SSC implements the plan supported by an appropriate budgetary allocation.</i></p>  |
| 3.5 | <p><i>SBV to develop SBV's banking human resources development (training) plan for the period 2011-2020.</i></p> <p>Status: Completed</p>   | <p><i>SBV to implement the human resource development (training) supported by available budget, with emphasis on monetary policy and policy makers responsible for development of the money market.</i></p>  |

\*Policy actions in bold are supported by ADB technical assistance.