DEVELOPMENT OF THE NATIONAL FINANCIAL SAFETY NET IN VIETNAM

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Abstract: After the world financial crisis in 2008, a lot of countries, including Vietnam, started to pay attention to setting up a financial safety net, in order to keep security for financial institutions specifically and financial systems generally. The paper analyzes the actual state of the national financial safety net in Vietnam and suggests measures to improve it, including: 1) setting up the model of national financial safety net; 2) building legal frameworks; 3) strengthening members' capacity; 4) mechanism of warning and intervention; and 5) develop international cooperation.

Key words: Financial safety net, framework, measure, mechanism, security.

1. Financial safety net

According to the International Monetary Fund (IMF), viewed from the perspective of a financial instituton, finnacial safety reflects the security extent of an institution, when it performs effectively inherent functions (funding allocation, provision of means of payment for economic activities etc...); at the same time, it is capable of restricting or tackling risks before the financial – banking system falls in danger. Financial safety of an intermediary financial institution can be seen, when properties and funds are stable to solve all debt responsibilities and risks; there is no crisis and the financial state looks sustainable. At a larger extent, financial safety of intermediary financial institutions is not only the financial state of each institution, but also the financial security of the entire system, where normal-scaled "shocks" stemming from an individual financial institution cannot cause a financial crisis for the financial system generally and other financial institutions particularly. According to the Organization for Economic Co-operation and Development (OECD), the financial safety net is a tool of the public policy, which is designed to minimize costs and risks relating to the crisis of financial institutions.

Based on the international conventions, the financial safety net of a country consists of the Ministry of Finance, the Central Bank, Financial Supervisory Authorities, Deposit Insurance organizations, and some others.

There are four elements in the financial safety net, including: deposit insurance; the ultimate creditor; prudent legal regulations and supervisory mechanism; and, the crisis management framework. The key target of the financial safety net is to do management and supervision of the financial system through the role of ultimate loan-borrowers, deposit insurance activities and the tools to deal with the bank failures.

Deposit insurance is set up, based on contributions (voluntarily or compulsorily

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by laws) made by commercial banks at a particular rate. It is a tool to protect partly or fully the bank deposits, aiming at keeping the public trust in the credit system. In reality, this tool is organized and implemented differently, depending on specific characteristics of the banking system in each country.

The ultimate creditor is an organization that gives the ultimate funds, when intermediary financial institutions have a crisis or serious difficulties in liquidity. This mission is often undertaken by the central banks. Owing to greater functions, resources and funding tools, the central banks can provide quick liquidity-related supports for intermediary financial institutions, helping them to restrict panic situations and risks that may spread fast.

Financial supervision helps to discover, prevent and deal with violations of the current regulations in the financial sector; and, finally it helps to maintain the stability for the financial market. The national financial supervisory body must be fully empowered to do supervision in all financial areas, markets and institutions; it may carry out distant or direct supervisions through national financial security norms and criteria (which are set up partly according to the best international conventions). The financial supervisory body uses macro security criteria and quantitative models to carry out supervision of insecurities/risks of the entire financial and economic system. Indicators of the macro financial supervision include: economic growth, balance of trade, current account deficit, foreign-exchange reserves, external debts vs. GDP, public debts vs. GDP, inflation, economic loans, and difference in the interest ratio between international and domestic bonds of the government.

Legal regulations, which are used to adjust activities of intermediary financial institutions and the financial system, also play an important role in the financial safety net. There is duplicity, however. If the legal regulations related to financial security are too restrictive, it will be difficult for intermediary financial institutions to develop. On the contrary, if the legal regulations are too loosely set up, letting the financial market go freely, risks and insecurities may happen to the financial system. The legal regulations involved with financial safety of intermediary financial institutions, therefore, should be frequently adjusted suitably with the general context of development.

After the global financial crisis in 2008, many countries realized that it was necessary to make forecasts and build coping plans, in order to keep security and avoid negative impacts from crises. Consequently, many countries set up the crisis management framework as a part of the financial safety net. The framework can be set up at the national level or at lower levels; for example, at the level of intermediary financial institutions.

Some other organizations also provide supports to keep financial safety. They may give emergency loans or market liquidity; they may give assistance in organizing financial activities or setting up a mechanism to solve failures of intermediary financial institutions. In a particularly serious situation, there will be interventions from the state-owned sector; for example, the government may sponsor for some debts in the public sector, nationalize some components of the financial system, reduce the supervisory burden, and loosen the monetary policy.

In setting up a financial system, it is essential to take into account of different factors. On the one hand, the factors are designed to avoid the collapse of the financial system. On the other hand, they aim at minimizing moral risks that will loosen desciplines at the market. If there is no appropriate financial safety net, just a rumor about the liquidity capacity of financial institutions may lead to a financial crisis at a small scale. If there is a financial safety net available, public trust in the financial institutions will be higher and the potential of a financial crisis will reduce. In reality, although there are relatively many risks involved with the financial system, ones do not pay much attention to preventive measures when designing the system. There are many causes for this, but the most important one is that it requires a lot of investments at the beginning as well as particiapation of highly-qualified human resources.

2. National financial safety net in Vietnam

At present, the financial safety net in Vietnam is recognized via two major tools, including: Vietnam Deposit Insurance and the Supervisory System of intermediary financial institutions.

- *Vietnam Deposit Insurance (VDI)* was initially set up in 1999, providing insurance for deposits in Vietnamese currency (VND) up to 50 million VND for individuals, households, collectives, and private businesses. Higher amount of insurance is currently under consideration. The State Bank is responsible for supervising deposit insurance activities. Memoranda have been signed between financial management institutions and cross-border cooperation has been set up, but information sharing among members of the financial safety net has not been effective yet.

Till the end of June 2013, Vietnam Deposit Insurance carried out periodically supervisory activities for 100% of participating organizations, including 90 banks and nonbanking credit organizations, the Central People’s Fund, and 1,141 local people’s credit funds. During the first half of 2013, Vietnam Deposit Insurance completed its inspection of 15 commercial banks and 139 local people’s credit funds. In June 2013, Vietnam Deposit Insurance directed its local branches to review and inspect the local people’s credit funds that were at high risk. The inspection and reviews will help Vietnam Deposit Insurance to take the initiative in building and suggesting appropriate measures for the organizations.

The deposit insurance mechanism, however, has not been yet used to deal with bad debts or the bank problems, as ones still remain afraid that the banks will close down or put into liquidation. When a bank is forced to carry out restructuring, Vietnam Deposit will not be involved. Yet, it hardly takes part in dealing with the financial organizations that have problems, due to its limited functions as well as limited financial capacity. In addition, this requires a lot of human resources.

At present, the balance of the deposit insurance is just 0.8% of the total amount of deposits; whereas the expected balance should be 3 - 5% of the total amount of deposits. (It is a necessary resource to deal with two medium-sized organizations). Deposit Insurance has made many investments into its member organizations and it may borrow funding from them. If one of those organizations faces a problem relating to liquidation or it does not have enough capacity for payment, deposit insurance funds will be put in danger, making it difficult for liquidity; consequently, risks relating to investments or loans of deposit insurance funds will be much higher.

- *The system of supervisory institutions* in the financial safety net in Vietnam consists of some major bodies, such as: the State Bank, the Ministry of Finance (mainly via the functions of the State Security Commission and the Department of Insurance Management and Supervision), the National Financial Supervisory Commission, and Vietnam Deposit Insurance.

At present, each intermediary financial organization is under direct management and supervision of one body. Commercial banks are under management and supervision of the Inspection and Supervision Department (of the State Bank); stock - exchange companies are directly supervised by the State Security Commission; and, insurance companies are under supervision of the Department of Insurance Management and Supervision. In addition, the National Financial Supervisory Commission is responsible to make recommendations on coordination and supervision of the financial market (including banks, security, and insurance) to be submitted to the Prime Minister; it assists the Prime Minister in supervising the financial market as well. Each of the above-mentioned bodies has to report to its higher authority. The Inspection and Supervision Department, which supervises commercial banks, is under administration of the State Bank (an administratively ministerial-level institution); it submits reports and recommendations to the State Bank. The State Security Commission and the Department of Insurance Management and Supervision are under administration of the Ministry of Finance; they therefore submit reports and recommendations on management of intermediary financial institutions to the Minister of Finance. The National Financial Supervisory Commission is established to work as a counselling agency for the Prime Minister.

In general, there are all necessary member institutions for a national financial safety net in Vietnam. The member institutions, however, have not coordinated with each other closely yet. The task of coordinating supervisory activities for the national financial safety is undertaken by the National Financial Supervisory Commission. In fact, the role in coordinating acivities of supervisory institutions is played very ineffectively by the National Financial Supervisory Commission; and, it is even evaluated that the Commission has not played the role at all. The reason is that the Commission is established as a counselling agency; it thus has no policy-making functions and it is not empowered to carry out supervision or deal with cases. As a result, this has led to four shortcomings relating to supervisory activities of the financial safety net in Vietnam, as below:

Firstly, member institutions of Vietnam Financial Safety net have encountered a lot of problems involved with development tendencies of financial corporations for the past time. Lack of macro-scale systematic supervisions was one of important causes of the fact that many financial corporations made corrupt use of legal loopholes.

Secondly, supervisory institutions in the Financial Safety net have had a lot of difficulties in doing supervision of new integrated financial products. As the new integrated products are involved with many different financial products, it is complicated to identify which institution will undertake the responsibility to do supervision.

Thirdly, the framework of supervisory criteria has not been fully built. The criteria relating to early warning have not been synchronous, making the risk management and preventive measures remain less effective.

Fourthly, the current legal documents have not yet mentioned the concept of financial safety net. Vietnam's laws have not identified responsibilities that specific member institutions in the Financial Safety net will have to undertake, when a crisis takes place or a bankruptcy happens. Thus, different institutions sometimes carry out overlapping supervisory activities at the same field; whereas, some other fields are omitted at all. Consequently, resources are wasted and risks become higher. Generally, the lack of macro safety supervision from relevant institutions has resulted in financial supervisory shortcomings in Vietnam.

3. Measures to develop the national financial safety net in Vietnam

The concept of financial safety is very new in the world. It was mentioned for the first time, after the financial crisis in 2008. Vietnam therefore still lacks a lot of elements to build and develop a national financial safety net. To make the financial safety net become a macro management tool and develop fully its role in ensuring financial safety not only for individual financial institutions but also for the whole system, we need to carry out some specific measures in the coming time, as follows:

3.1. To set up the model of the national financial safety net

There are now necessary components for a national financial safety net in Vietnam, but they have not been completely sufficient and have not linked closely with each other. To save the cost of setting up the national financial safety net, it is possible to use available institutions to establish the Council of National Financial Supervisory Institutions, which should be chaired by the National Financial Supervisory Commission. Yet, there must be a general framework and specific regulations to share information and connect the above-mentioned institutions effectively.

Australia is a country, where the financial safety net has been run very well. The International Monetary Fund (IMF) recommended that other countries should learn experience from Australian financial safety net model, as Australia has a history of few bank failures, even fewer financial crises, and its banking sector emerged from the global financial crisis relatively well. Australian financial framework consists of state-owned organizations empowered with specific duties: (1) the Central Bank undertakes the management of monetary policy and payment system; it plays the role as the ultimate creditor and takes the responsibility to maintain stability of the financial system; (2) the Financial Safety Legislative Department undertakes the supervision and adjustment of intermediary financial institutions (banks, commercial companies, and insurance companies); it plays the role in balancing financial safety with effectiveness and competitiveness of the institutions as well as in protecting interests of depositors and clients of the institutions; (3) the Treasury and the Ministry of Finance supervises the use of public funds to provide supports for financial institutions; it also undertakes the crisis management role and takes control over provision of the Governement's financial supports for the institutions that are encountering problems; (4) the State Stock Exchange Commission makes assessments and advice about the situation of crises to be provided for investors and the financial market; it announces relief activities involved with mass financial institutions. The four above-mentioned organizations coordinate very closely with each other; they share information very frequently via the Council of Financial Managers. The goal is to create a forum for dialogue and effective cooperation among financial managers. Normally, the forum enables all members to share information and set up policy research groups. At the time of a crisis, the forum helps to set up cooperation to cope with financial instabilities.

3.2. To build a legal framework for establishment of the national financial safety net and make clear regulations about cooperation and information sharing among components of the financial safety net

The concept of financial safety net should be legalized in documents. It is necessary to define clearly the roles and functions of each member organizations as well as their relationship and interaction in maintaining stability and safety of the financial system generally; overlapping management and supervision of financial institutions should be avoided. It is essential to define specifically structure, power and responsibilities of each member organization. Especially, those of the general supervisory authority (the National Financial Supervisory Commission) must not overlap those of the organizations at lower levels, which directly carry out management and supervision of intermediary financial institutions.

However, intermediary financial institutions are not run separately, but they operate together in the same national financial system. Supervisory organizations, therefore, have to collaborate closely with each other and share information effectively, in order to carry out synchronously supervisory activities. Experience learned from the model of the Australia financial safety net shows that the four above-mentioned organizations cooperated with each other to establish the National Financial Supervisory Council. This is completely feasible in Vietnam, since all the relevant organizations have the same rank of administration (belonging to a ministry or an organization at the ministerial level), except for the National Financial Supervisory Commission, which is directly under the administration of the Prime Minister. The National Financial Supervisory Council may be chaired by the National Financial Supervisory Commission, the State Bank or the Ministry of Finance, in order to set up a common forum for cooperation between member organizations that undertake direct management and supervision of intermediary financial institutions. The Council should be operated frequently all the time, when economic development goes swimmingly as well as when a financial crisis takes place. The frequency of meetings can be once a quarter; extraordinary meetings should be held for discussion about common issues at the time of supervision or when signs of instability require prompt solutions. It is necessary to build crisis preventive measures for each financial institution and the entire national financial safety net as well.

3.3. To build and strengthen capacity of member organizations in the National Financial Safety Net

To do this, it is essential to:

- *Set up the ultimate creditor*. An effective financial safety net often requires general insurance mechanisms, which play the role like the ultimate creditor in economy. In Vietnam, there have not been yet any organizations playing the role of the ultimate creditor, except for the State Bank. There is no organization providing financial supports for stock exchange companies or insurance companies, when they encounter a crisis. To strengthen the role of the ultimate creditor, therefore, it is necessary to establish additional organizations, which will provide financial supports for every intermediary financial institutions. The State Bank may expand its role as the ultimate creditor, providing financial safety supports for not only commercial banks but also other intermediary financial institutions. Apart from the national financial safety net, Vietnam should consider its participation in the regional and global financial safety nets, where it may build effective relationships with internationally ultimate creditors, such as IMF or WB.

- *Strengthen further the role of deposit insurance organizations.* Deposit insurance is one of important components of the financial safety net, as it restricts the risk that depositors flock into commercial banks to make withdrawals, and limits the risk of liquidation as well as stabilizes the country economy. For deposit insurance, two factors must be reasonably set up to keep safety for both commercial banks and depositors, including: (1) the extent of deposit insurance. It should not be 100%, but it should be some percentage that can maintain the trust of depositors and create dynamics for supervision of commercial banks' activities, owing to which moral risks can be lessened. (2) the extent of contributions made by commercial banks into deposit insurance (or the fees of deposit insurance). It should be reasonably set up to ensure the funding for operation of Vietnam Deposit Insurance. In addition, the fees must be justified for intermediary financial institutions. The contribution they have to make should correspond to their specific extent of risks. This also encourages the institutions to improve their own financial situation. Such a fee mechanism is called as the risk-based fee mechanism.

At present, the Deposit Insurance just provides safety for depositors of commercial banks. In reality, other financial institutions may have high risks like commercial banks. For example, customers of a stock exchange company also have deposit accounts in the stock trading floor. When a financial problem occurs, they may make massive withdrawals, exhausting liquidity of the company. This will then spread to other financial institutions, which are still operating well. Thus, it is also necessary to set up insurance mechanisms for customers of all other financial institutions. The Stock Investor Protective Fund, for example, should be established to provide safety for trading deposits of investors.

3.4. To set up a framework of mechanisms as well as criteria for early warning and early intervention in financial unsafe cases of the entire system

To keep financial safety for the entire system, making it stable and preventing a widespread crisis or a follow-up crisis, it is necessary to have a coping mechanism to make early intervention in the intermediary financial institutions that have a problem. This can be achieved, only when relevant organizations have been prepared with a measure that was already tested and practiced; at that time, they will not be too passive in coping with a crisis. Crisis management and controlling strategies should be built in advance through policies, instructional documents and drafts, when dealing with the simulated situation of a crisis.

Furthermore, relevant organizations need to set up a mechanism for early interventions in the intermediary financial institutions when necessary, before an unsafe situation happens to the whole system. The early intervention mechanism will include both frequent supervising and monitoring activities of intermediary financial institutions; especially, it will keep track of new products and provide financial supports for institutions, when they operate normally and when they are facing a crisis as well.

3.5. To develop cooperation and information - sharing with other countries in the region and the world as well.

This brings a lot of interests to the whole financial system of Vietnam generally and intermediary financial institutions specifically. In other Southeast Asian countries, market characteristics, development features, scales and culture of investment are almost similar to those in Vietnam. Thus, information - sharing with those countries will help Vietnam to learn valuable lessons in keeping financial safety for the entire system as well as for each specific financial institution. Moreover, Vietnam's financial system is a very part of the global financial system. International cooperation and participation in the global financial safety net, therefore, will enable Vietnam to get supports from international community. Mechanisms of deposit insurance and financial responsibility insurance in other countries can provide assistance, when Vietnam's financial system encounters a financially unsafe problem. The organizations that play the role as the ultimate creditors such as IMF and WB can give some assistance in tackling and controlling a crisis through advice, financial supports and resources to help Vietnam stabilize its financial market etc... To get effective cooperation and information-sharing, it is important for Vietnam's financial system and intermediary financial institutions to renovate activities, promoting international and regional integration and applying international standards as well as following the world criteria for assessment of financial safety such as BASEL III and CAMELS etc...

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