

# PERSPECTIVE

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## Rising Risks from Cross-ownership between Real Estate Developers and Banks in Vietnam

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*This photograph on 4 December 2020 shows workers carrying goods past a building still under construction in Hanoi. Picture: Nhac NGUYEN / AFP.*

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**EXECUTIVE SUMMARY**

- Since 2010, cross-holdings in commercial banks have been considered by Vietnamese policy makers as a critical issue; this practice encourages non-compliance activities by financial institutions, such as the bypassing of credit risk regulations.
- By 2019, thanks to banking reforms led by the State Bank of Vietnam, this issue had been effectively managed.
- However, a more sophisticated form of cross-holdings has emerged in recent years, with more and more real estate developers becoming key decision-makers in local banks.
- Real estate developers' ownership in commercial banks exposes Vietnam to the same problems that China is facing, with poorly capitalised real estate companies borrowing heavily from banks via their complex network of affiliates, thereby exposing these banks as well as the whole banking system to great risks.
- In order to deal with these risks, regulators need better tools to trace the ultimate ownership of commercial banks and mitigate ownership concentration. Requiring board diversity and enhancing the role of independent directors are some of the best practices that Vietnam can adopt.

## **INTRODUCTION**

China's economic stability has recently been threatened by the debt problem of major real estate developers, with Evergrande being the most notable case.<sup>1</sup> This has led to concerns that similar problems may happen to other countries in the region. In Vietnam, debates about this risk among policy makers and industry experts have intensified, as several real estate developers have recently emerged as major shareholders or key decision-makers in local banks.

This paper analyses the risks that this phenomenon poses to Vietnam's banking system and discusses how Vietnam can handle this issue. We first review Vietnam's banking reforms since 2011, focusing on the cross-holdings issue. We then link this to the risks posed by local real estate developers' investment in banks, and discuss possible consequences. Finally, we recommend some policies and best practices that Vietnam can adopt to mitigate the risks.

## **WHY DO REAL ESTATE DEVELOPERS WANT TO CONTROL BANKS?**

Reducing cross-holdings in commercial banks has been an important goal for Vietnamese policy makers since 2010. The fast growth of commercial banks in the 2000s was associated with the emergence of complicated ownership structures within these banks. Some banks held shares in other banks, while some were owned by non-financial companies, both private and state-owned, which were also these banks' major clients. Such ownership structures were established through either direct or indirect links with these companies' affiliates.<sup>2</sup>

In 2010, the State Bank of Vietnam (SBV), the country's central bank, decided that cross-ownership among banks was a worrying trend as this practice encouraged non-compliance activities by financial institutions and major shareholders of commercial banks, including the bypassing of credit risk regulations. At the end of 2011, four state-owned commercial banks, namely Vietcombank, BIDV, VietinBank and Agribank, were holding shares in eight private-owned joint-stock commercial banks. For example, Vietcombank held an 11 per cent stake in Military Bank, an 8.2 per cent stake in Eximbank, a 4.7 per cent stake in Oriental Bank, and a 5.3 per cent stake in Saigon Bank. Private-owned commercial banks also held each other's shares. For example, Eximbank owned 10.6 per cent of Sacombank and 8.5 per cent of Viet A Bank.<sup>3</sup>

After some deliberation, in 2014, the SBV issued Circular 36/2014/TT-NHNN to address this cross-holding problem.<sup>4</sup> The circular clarifies the definition of persons related to key decision-makers of commercial banks. It also requires additional disclosures on the ownership of related persons in commercial banks and the banks' provision of credit to these persons. At the same time, the circular provides that a commercial bank can only hold less than 5 per cent of another financial institution's equity. Thanks to these efforts, by June 2019, the number of pairs of financial institutions with cross-holding relationships had been reduced from 56 to only one.<sup>5</sup> Thereafter, SBV Governor Nguyen Thi Hong claimed that

the issue of cross-holding in financial institutions had been “effectively handled”, and the problem of major shareholders manipulating banks had been managed.

However, while cross-ownership between banks may have virtually been eliminated, other types of complex ownership structures in the banking system have emerged. One particularly worrying trend is the participation of local real estate developers in banks; it is feared that this can adversely influence these banks’ lending practices.

Ownership structure reports issued by local banks suggest that most of them comply with regulations against cross-holdings issued by the SBV, such as the rules specified in Circular 36/2014/TT-NHNN. However, these regulations do not cover the issue of companies that are affiliates of bank shareholders holding shares in these banks. In most cases, such companies engage in different businesses, including capital-intensive ones such as real estate. These companies’ participation in banks is not driven by these banks’ profits, dividends, or stock price appreciation. Instead, the main benefit of their participation is the ability to influence these banks’ lending practices, including non-compliance activities such as providing excessive lending to certain clients. Essentially, real estate developers who can somehow control banks can channel more credits to their real estate projects by lending to these developers’ affiliates. They can even use employees as nominees to open companies to obtain loans from banks and then channel the money back to their businesses. It is hard to trace such transactions without thorough forensic audits, which are normally conducted only when major scandals break out.

Although it is difficult to trace these transactions and obtain definitive evidence, there are clear indications that some commercial banks are being controlled by real estate developers. For example, in May 2021, Tran Thi Thu Hang, CEO of Sunshine Group, a rising real estate developer with major projects in Hanoi and Ho Chi Minh City, became chairwoman of Kienlongbank. In the same month, Nguyen Duc Thuy, founder and major shareholder of Thaiholdings, a conglomerate with diversified interests, including in real estate and renewable energy, was elected vice-chairman of LienVietPostBank after Thaiholdings, Thuy and his family members bought large amounts of the bank’s shares. As of December 2021, although Thaiholdings and Thuy’s relatives had putatively divested from LienVietPostBank, Thuy remained the bank’s vice chairman. In a more recent case, National Citizen Bank (NCB) appointed Bui Thi Thanh Huong, CEO of Sun Group, a major real estate developer well-known for large hospitality and entertainment complexes, as its chairwoman in July 2021. NCB is known to have made several loans to Sun Group, including for a major casino project in Van Don, Quang Ninh Province.

These developments reinforce a trend that has long existed in Vietnam’s banking industry, where local tycoons try to gain control of commercial banks as a way to provide cheap funding for their businesses, especially in the real estate sector. Notable examples of such a relationship between bank and real estate developers include Techcombank and Masterise Group, VPBank and MIK Group, SEABank and BRG Group, Saigon Commercial Bank and Van Thinh Phat Group, HDBank and Sovico Group, and Sacombank and Him Lam Group.<sup>6</sup>

## **INCREASING RISKS FROM REGULATORY ARBITRAGE**

Against this backdrop, there have been concerns that real estate developers may distort the lending practices of these banks to benefit their other businesses. In March 2021, it was reported by local media that new forms of cross-holdings, i.e., real estate developers controlling banks, may be driven by regulatory arbitrage. According to the Law on Credit Institutions, the total loan a financial institution can lend to a single customer must not exceed 15 per cent of its capital, and the total outstanding loan to a customer and that customer's related persons must not exceed 25 per cent of its capital. This balance includes bonds issued by companies of the customer to the lending institution.<sup>7</sup>

Since most real estate developers own multiple subsidiaries, they can circumvent the limits set out by this regulation by having these subsidiaries borrow from banks. In addition, these developers may also use affiliated businesses whose owners are putatively not related to them to borrow from the same banks. In such cases, banks can lend to these affiliated groups more than 25 per cent of their own capital without knowing that they have actually crossed the limit. While the risk management system of commercial banks can raise red flags over these transactions, bank managers, who are also real estate developers or who have close connections with them, may suppress such warnings. There have been similar cases in European banks, such as Credit Suisse in the Greensill Capital scandal, where risk managers' warnings were ignored and suppressed by the bank's executives.<sup>8</sup>

The SBV's Circular 22/2019/TT-NHNN, which came into force on 1 January 2020, further incentivises real estate developers to acquire major stakes in commercial banks.<sup>9</sup> This circular aims to address banks' maturity risk and slow down the credit flows to risky sectors, including real estate. Specifically, it requires that the ratio of short-term deposits to medium and long-term loans does not exceed 40 per cent for the period between 1 January 2020 and 30 September 2020. After this period, the ratio would go down further, to 37 per cent by October 2020 and eventually to 30 per cent by 2022. Additionally, loans to the real estate sector would carry a high-risk weight of 200 per cent, a significant increase from 150 per cent.<sup>10</sup> This change results in higher risk-weighted assets, and thus reduces banks' capital adequacy ratio. In other words, if a bank maintains the same level of assets (including loans and investments) as before the increase of risk weights, it is considered to be subjecting itself to higher risks. Furthermore, if the bank's capital adequacy ratio drops too low, it will need to raise capital to maintain the minimum ratio specified by the SBV. This regulation therefore limits the asset and credit growth of commercial banks that are not well capitalised.

Due to these new restrictions, the growth of credit to the real estate sector declined from 21 per cent in 2019 to 11.89 per cent in 2020.<sup>11</sup> Real estate developers now therefore have stronger motivations to become major shareholders in commercial banks to gain easier access to capital. The above-mentioned cases of cross-holdings between banks and real estate developers may only be the tip of the iceberg. There could have been other cases where real estate developers have major influence on commercial banks, but it is nearly impossible for the public and the media to trace the ultimate owners of these banks due to their complex and opaque cross-holding structures.

Some industry experts have warned about the risks associated with this new form of cross-holdings in the banking system, particularly amid disruptions to the real estate market caused by the Covid-19 pandemic. For example, Le Xuan Nghia, former vice-chairman of the National Financial Supervisory Committee, emphasised that real estate companies serving as “backyards” of commercial banks need special attention from regulators.<sup>12</sup> He pointed out that several real estate developers have weak balance sheets, high debt-to-total asset ratio, and low liquidity ratio, and that their financial position “may be even worse than Evergrande’s”.<sup>13</sup> He also argued that the true picture is blurred by a thick “financial fog”<sup>14</sup> and the common practice of developers using nominees, such as their drivers, house-keepers and security guards, to set up affiliates to get bank loans on their behalf. He warned that if regulators failed to supervise carefully, cases like Evergrande would soon emerge in Vietnam.

Such concerns are well-founded and informed by past scandals in which banks’ ultimate owners channelled these banks’ money to their own pocket, causing heavy losses to the banks and putting the whole financial system at risk. One primary example is the case of Pham Cong Danh and the Vietnam Construction Bank (VNCB). As the former chairman of the bank, Danh has been prosecuted and jailed for “stealing money” from his bank and using the funds to secure loans from other lenders.<sup>15</sup> It is estimated that between 2012 and 2014, Danh caused VND9,000 billion (USD392 million) in losses to VNCB.

However, some others downplay the risk of real estate developers’ involvement in commercial banks. For example, Nguyen Tri Hieu, a banking expert, argues that the new owners of banks have changed their mindset. Given the stricter regulations imposed by the SBV, Hieu suggests without elaboration that the participation of real estate developers as well as companies from other industries in banks may actually be a good thing for the economy. Nevertheless, Hieu also admits that they need to learn from cases like VNCB and avoid repeating the same mistake.<sup>16</sup>

## **PROSPECTS AND RECOMMENDATIONS**

We concur that if leaders of real estate companies, who are also ultimate owners of certain banks, follow the rulebooks of the SBV, the situation will be under control. Vietnam’s current banking regulations have clearly indicated the limit that a bank can lend to a client, as well as to a client and its related parties. Furthermore, with the implementation of Basel 2 and Basel 3 standards in Vietnam, capital adequacy and internal controls have been enhanced at most banks. Market discipline may also deter bad governance behaviours, and cases like VNCB can thus be prevented.

However, while it is now harder for real estate tycoons to manipulate banks, there are still certain loopholes that they can take advantage of. Through the complex networks of subsidiaries and affiliated companies, these ultimate shareholders can channel credits to their own companies, bypassing regulations on credit and lending limits for the real estate sector. For example, they can interfere so that banks will lend to affiliates that are not directly involved in the real estate sector by building up shell companies in other industries

to borrow from banks. At the end of the day, money will still be channelled to their real estate business through these shell companies.

With the rise of shadow banking, fintech app and retail lending arms, these wealth transfers can become too complicated to trace as shell companies can borrow from different arms of a commercial bank. It is therefore extremely hard for regulators to determine how much a bank is exposed to an ultimate borrower. It is also difficult for regulators to monitor which banks are exposed to cross-holdings by real estate developers and act before a problem becomes too big to tackle. Real estate developers can continue to come up with new ways to manipulate banks, and regulators are usually a few steps behind.

Even if only a few banks in the financial system have these governance loopholes, there is still a significant risk for over-indebted developers to emerge from the above-mentioned unhealthy practices. There are also concerns that banks' operating performance may deteriorate if its leaders focus on lending to their "backyard companies", while neglecting the banks' main businesses. This will lead to the misallocation of banks' resources and reduce the effectiveness of the banking system in providing capital for the economy. Furthermore, due to the wish to maintain these practices to benefit themselves, bank owners may not have the incentive to promote digitalisation of the banking system. Consequently, the competitiveness of Vietnamese banks may decline compared to foreign banks.

To avoid these risks, regulators need a better information system to trace the ultimate ownership of commercial banks and mitigate ownership concentration. Furthermore, requiring board diversity and enhancing the role of independent directors are best practices that Vietnam can adopt. When ownership is not concentrated into a few large shareholders and independent directors can challenge shady business practices, banks will be better governed and better prepared to deal with external shocks. There will also be lower chances for cases like Evergrande to emerge in Vietnam.

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<sup>1</sup> Alexandra Stevenson and Cao Li, "Why China's Economy Is Threatened by a Property Giant's Debt Problems," *The New York Times*, 10 November 2021, <https://www.nytimes.com/article/evergrande-debt-crisis.html>.

<sup>2</sup> Xuân Thành Nguyễn, "Commercial Banks of Vietnam: From Legal and Policy Changes in the Period 2006-2010 to Restructuring Events in the Period 2011-2015," *Fulbright Economics Teaching Program*, February 2016.

<sup>3</sup> Văn Luyện Lê and Duy Tuấn Khuất, "Sở Hữu Chéo Giữa Các Ngân Hàng Thương Mại Việt Nam Sau Khi Ra Đòi Thông Tư 36," *Tạp Chí Ngân Hàng*, 2 October 2017, <http://tapchinganhang.gov.vn/so-huu-cheo-giua-cac-ngan-hang-thuong-mai-viet-nam-sau-khi-ra-doi-thong-tu-36.htm>.

<sup>4</sup> The circular can be accessed at

<https://vanban.chinhphu.vn/default.aspx?pageid=27160&docid=178433>

<sup>5</sup> Đinh Vũ, "Thông Đốc Nguyễn Thị Hồng: Hệ Thống Ngân Hàng Không Còn Tình Trạng Sở Hữu Chéo," *Nhà Đầu Tư*, 28 January 2021, <https://nhadautu.vn/thong-doc-nguyen-thi-hong-he-thong-ngan-hang-khong-con-tinh-trang-so-huu-cheo-d47956.html>. The only remaining case is between Asia Commercial Bank (ACB) and Real Estate Investment Hòa Phát - Á Châu (ACB holds 2.86

per cent of Hòa Phát – Á Châu while that company owns 0.046 per cent of ACB). It remains unclear why this case was not resolved.

<sup>6</sup> Khanh An, “Khi đại gia Việt ‘cười’ ngân hàng”, *Nhà Đầu tư*, 30 July 2021, <https://nhadautu.vn/khi-dai-gia-viet-cuoi-ngan-hang-d55714.html>

<sup>7</sup> Hà Tâm, “Bóng Dáng Sở Hữu Chéo Trong Hệ Thống Ngân Hàng,” *Đầu Tư Online*, 3 March 2021, <https://baodautu.vn/bong-dang-so-huu-cheo-trong-he-thong-ngan-hang-d138940.html>.

<sup>8</sup> Marion Halftermeyer, “Credit Suisse Overruled Risk Managers on Greensill Loan”, *Bloomberg*, 11 March 2021, <https://www.bloomberg.com/news/articles/2021-03-11/credit-suisse-overruled-risk-managers-on-loan-to-greensill>.

<sup>9</sup> Circular 22/2019 is available at: <http://congbao.chinhphu.vn/noi-dung-van-ban-so-22-2019-tt-nhnn-30003?cbid=28657>

<sup>10</sup> Kiều Linh, “‘Nấn’ Dòng Vốn Vào Bất Động Sản,” *VnEconomy*, 23 November 2020, <https://vneconomy.vn/nan-dong-von-vao-bat-dong-san-646111.htm>.

<sup>11</sup> Minh Phương, “Ngân Hàng Nhà Nước Nói Gì về Tín Dụng Rớt Vào Bất Động Sản, Chứng Khoán?,” *Báo Tin Tức*, 21 June 2021, <https://baotintuc.vn/thi-truong-tien-te/ngan-hang-nha-nuoc-noi-gi-ve-tin-dung-rot-vao-bat-dong-san-chung-khoan-20210621151937032.htm>.

<sup>12</sup> “Backyards” or “backyard companies” are terms commonly used in Vietnam to refer to companies that are related to key decision-makers of a business or a government official, normally without the knowledge of the public.

<sup>13</sup> Đào Vũ, “Hồi Chuông Cảnh Báo Từ ‘Bom Nợ’ Evergrande,” *VnEconomy*, October 2021, <https://vneconomy.vn/hoi-chuong-can-h-bao-tu-bom-no-evergrande.htm>.

<sup>14</sup> “Financial fog” or “sương mù tài chính” is a term coined by Le Xuan Nghia in his interview with *VnEconomy* to describe the lack of transparency in banks’ asset quality. Several troubled loans were not classified as bad debts thanks to SBV’s current regulations which are designed to support commercial banks and their customers during the Covid-19 pandemic.

<sup>15</sup> Hai Duyen, “Vietnamese Banks Protest after Prosecutors Call for \$266 Million to Be Returned at Fraud Trial,” *VnExpress International*, 26 January 2018, <https://e.vnexpress.net/news/business/vietnamese-banks-protest-after-prosecutors-call-for-266-million-to-be-returned-at-fraud-trial-3704021.html>.

<sup>16</sup> Nhuệ Mẫn, “Chuyện đại gia bất động sản góp vốn tại ngân hàng”, *Đầu tư chứng khoán*, 13 August 2021, <https://tinnhanhchungkhoan.vn/chuyen-dai-gia-bat-dong-san-gop-von-tai-ngan-hang-post276622.html>

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