Banking Sector

Banks will require VND283 trillion of subordinated bonds over the next three years to support funding and capital needs

CONTACTS

Phan Duy Hung, CFA, MBA
Director – Senior Analyst
hung.phan@visrating.com

Nguyen Duc Huy, CFA
Associate Analyst
huy.nguyen@visrating.com

Simon Chen, CFA
Head of Ratings & Research
simon.chen@visrating.com

Over the last 5 years, Vietnamese banks have increased their reliance on market funds to supplement long-term funding and capital requirements for business growth amid sluggish deposit growth. As credit growth picks up over the next 1-3 years, banks will need over VND283 trillion of new subordinated (tier 2) bonds to supplement their internal capital generation and maintain stable capitalization.

Banks have increased long-term bond issuances in recent years to supplement their funding and capital needs and maintain regulatory compliance. Banks issued a total of VND196 trillion bonds in 2023, higher than VND104 trillion in 2019; and tier 2 bonds accounted for 35% of the bonds issued. Banks use bond funding to better match their long-term loans and comply with regulatory requirements: limit the use of short-term funds for medium and long-term loans below 30% and maintain loan-to-deposit ratios below 85%.

Meanwhile, state-owned banks (SOBs) and several small private banks utilize more tier 2 bonds within their capital structure to overcome constraints in raising new capital and supplement their low tier 1 capital.

We expect the banking sector to issue over 283 trillion VND of new subordinated bonds over the next three years. We expect close to 55% of new tier 2 bonds will be issued by SOBs due to the significant amortization of their tier 2 capital. Under local regulations, the outstanding tier 2 bonds recognized as regulatory capital are reduced (i.e. amortized) by 20% per annum in the last five years of the bond tenor.

Banks will need to issue new subordinated debt to replace the amortized bonds and boost capital levels. A few small banks with weak profitability will issue tier 2 bonds to support their capital adequacy ratio by 3-4%. In addition, some mid-sized and large private banks will utilize tier 2 bonds to support their strong credit growth.

We expect retail demand for tier 2 bonds will remain strong. Retail investors hold most of the outstanding tier 2 bonds issued via public offerings, largely due to the higher yields of these bonds relative to bank deposits and senior bonds. Bank bonds were mostly issued as private placements that, in the past, allowed issuers to raise funds in shorter time frames and with minimal legal and documentary requirements. We expect to see more tier 2 bonds issued via public offerings to tap the strong retail demand, as bond issuers can no longer sell private placement bonds to retail investors who are not accredited as professional investors.

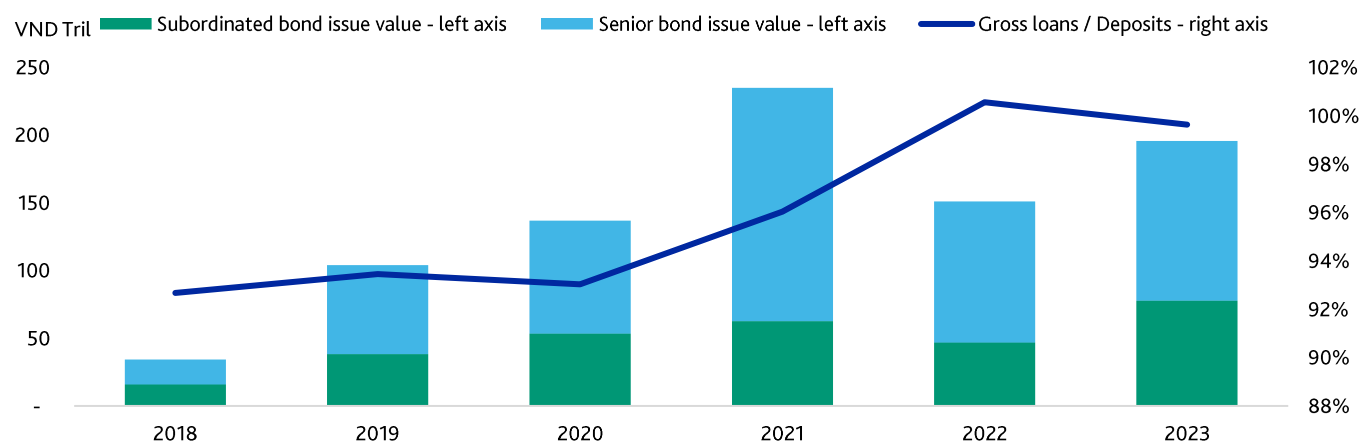
Nevertheless, investors need to be aware of the investment risks of fixed-income instruments that are not backed by payment guarantees or insurance against payment delays and are prone to early redemptions.

Banks in Vietnam have increased long-term bond issuances in recent years to supplement their funding and capital requirements for business growth

While primarily deposit-funded, banks have raised longer-term funding over the last 5 years

Sluggish deposit growth amid weak operating conditions in 2021-2022 drove banks to raise bond funding to support credit growth. The average gross loan-to-deposit ratio for the banking sector rose significantly and peaked at 101%, as banks struggled to gather enough retail and corporate deposits (Exhibit 1).

Exhibit 1: Bank bond issuance has grown significantly over the last 5 years

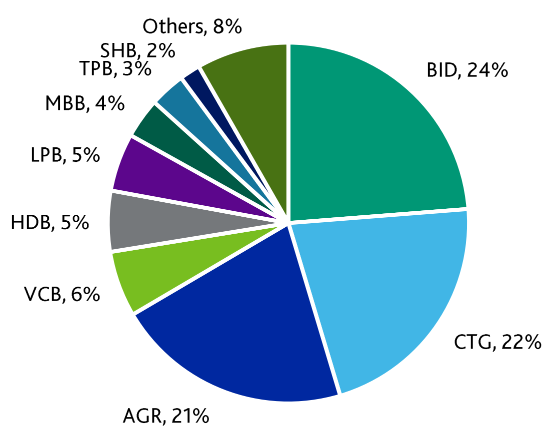


Source: HNX, Company data, Vietnam Investors Service

Banks issued a total of VND196 trillion worth of bonds in 2023, higher than VND104 trillion in 2019, and subordinated (tier 2) bonds accounted for 35% of the bonds issued.

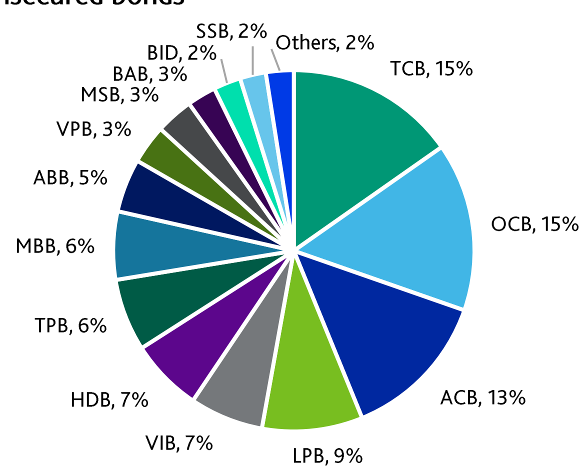
As of end-2023, 72% of total subordinated bonds outstanding were issued by SOBs (Exhibit 2), while 98% of total senior unsecured bonds were issued by privately-owned joint-stock commercial banks (JCBs, Exhibit 3).

Exhibit 2: The majority of outstanding subordinated bonds at end-2023 were issued by SOBs....



Source: Company data, Vietnam Investors Service
Note: Refer to the Appendix for the full name of banks

Exhibit 3: ...while JCBs issued the majority of senior unsecured bonds



Source: Company data, Vietnam Investors Service
Note: Refer to the Appendix for the full name of banks

Banks need longer-term funding to maintain compliance with regulatory funding and capital requirements

The State Bank of Vietnam (SBV) requires the banks to maintain several financial safety ratios, such as SMLR, LDR, and CAR, within the prescribed thresholds (Exhibit 4).

Exhibit 4: Bank's financial safety ratios and regulatory requirements

Ratios	Short-term funds for medium and long-term loans ratio (SMLR)	Loan-to-deposit ratio (LDR)	Capital Adequacy Ratio (CAR)
Guidance circular	Circular 22/2019/TT-NHNN[1] Circular 08/2020/TT-NHNN[2]	Circular 22/2019/TT-NHNN Circular 26/2022/TT-NHNN[3]	Circular 41/2016/TT-NHNN[4] Circular 22/2019/TT/NHNN
How ratio is computed	Medium and long-term lending minus medium and long-term funding, divided by short-term funding	Gross loans, divided by total funding such as customer deposits, deposits from the State Treasury, interbank funding, valuable papers	Total regulatory capital including equity (Tier 1), subordinated debt (Tier 2), etc., divided by Risk-weighted assets
Regulatory requirement	<30%	<85%	>8%

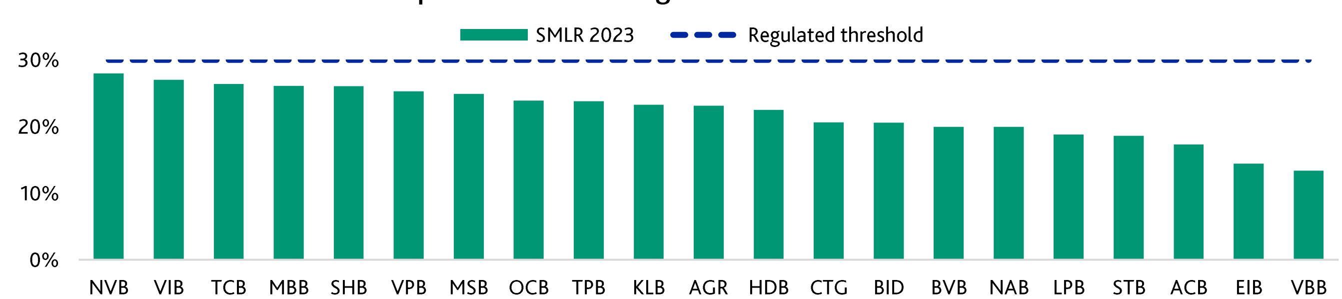
Source: Vietnam Investors Service

Both senior unsecured and tier 2 bonds issued by the banks can be used to meet the requirements, as they improve banks' funding stability.

Bonds have longer contractual tenors than other market funding instruments, such as interbank borrowings and certificates of deposits, and can reduce a bank's vulnerability to refinancing and liquidity risks. Tier 2 capital is used in local capital regulations as additional capital to protect a bank's solvency. Banks typically manage the high bond funding costs by deploying such funds to longer-duration loans and assets.

Prior to the implementation of the SMLR requirement in September 2019, banks relied heavily on short-term market funds for long-term lending to boost profits, resulting in significant liquidity mismatches. Banks that are rapidly growing their loans and with SMLRs close to the 30% cap are likely to seek new long-term bond funding sources (Exhibit 5). At end-2023, loan growth by these banks was at 24%, higher than the industry average of 16%; and 60% of their total loans were medium-to-long-term, surpassing the industry average of 44%.

Exhibit 5: Several banks are under pressure to meet regulated SMLR as of 2023

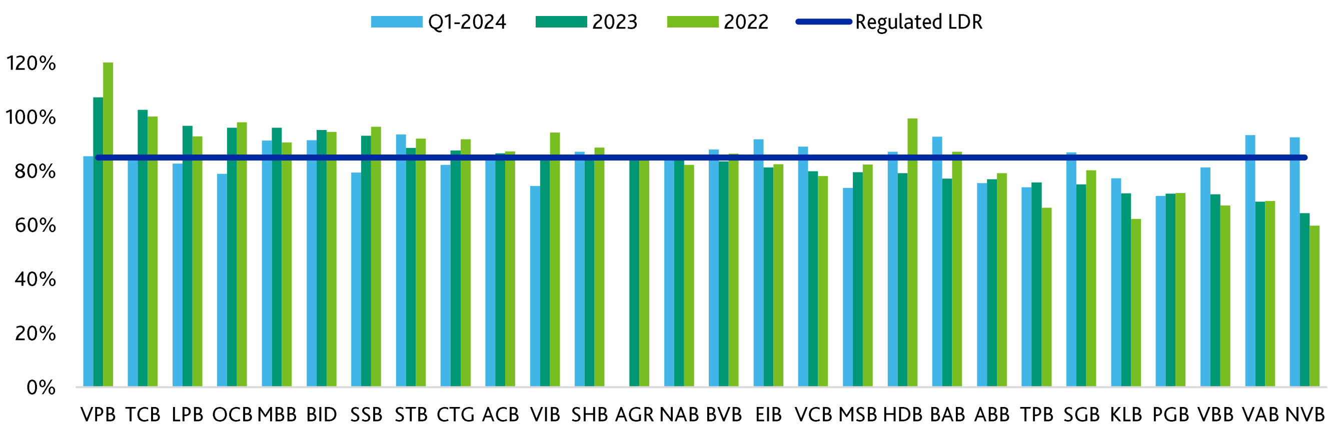


Source: Company data, Vietnam Investors Service
Note: Refer to the Appendix for the full name of the banks

[1] Refer to Circular 22/2019/TT-NHNN: Regulation on Banking safety ratios in the operation of banks and foreign bank branches
[2] Refer to Circular 08/2020/TT-NHNN extending the application date of the new SMLR ratio in Circular 22/2019/TT-NHNN
[3] Refer to Circular 26/2022/TT-NHNN revising the calculation method of LDR in Circular 22/2019. The gross loan-to-deposit ratio (LDR) equals gross loan divided by deposits including customer deposits, deposits from the State Treasury (with haircuts) and other CIs, and valuable papers.
[4] Refer to Circular 41/2016/TT-NHNN: Regulation on Capital safety ratio for banks and foreign bank branches

We also expect a handful of banks with gross loans to mobilized capital ratios significantly above 85% are likely to be close to the regulatory LDR limit, and hence, will require new bond funding (Exhibit 6).

Exhibit 6: Gross loans as a percentage of mobilized capital



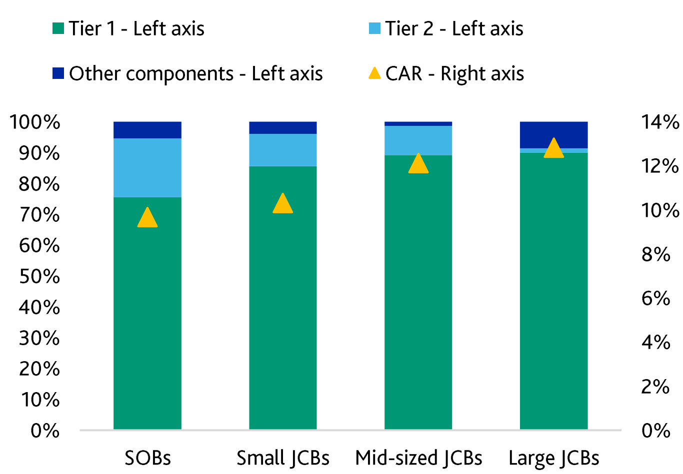
Source: Company data, Vietnam Investors Service
Note: Mobilized capital includes customer deposits, deposits from the State Treasury, and other credit institutions (CIs).
Refer to the Appendix for the full names of the banks

Most SOBs and several small JCBs rely on tier 2 bonds to overcome constraints in raising new capital

Across the banking sector, SOBs and small JCBs utilize more tier 2 bonds within their capital structure (Exhibit 7), to supplement their low tier 1 capital level and meet the regulatory capital requirements.

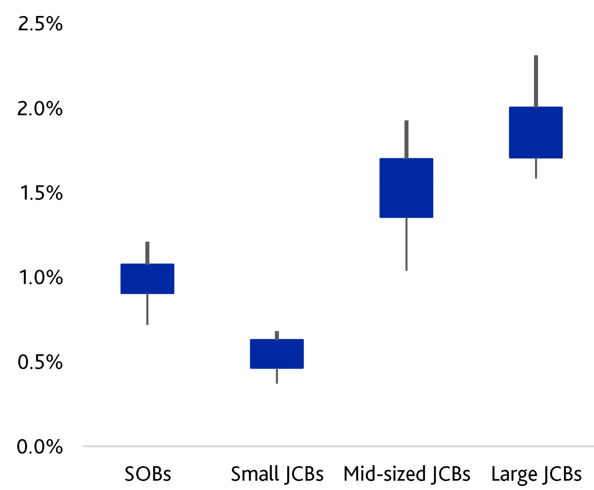
Low returns on average assets (ROAA, Exhibit 8) coupled with regular cash dividends to shareholders limit banks' ability to generate new core (i.e. tier 1) capital to support credit growth. SOBs have found raising new tier 2 capital to be more time-efficient than raising new equity, which will require a long administrative process.

Exhibit 7: Tier 2 bond is an important component for SOBs to meet regulatory capital ratio as of 6M2023



Source: Company data, Vietnam Investors Service
Note: Refer to the Appendix for the bank classification

Exhibit 8: SOBs and small JCBs are among the lowest ROAA as of 2023



Source: Company data, Vietnam Investors Service
Note: Refer to the Appendix for the bank classification

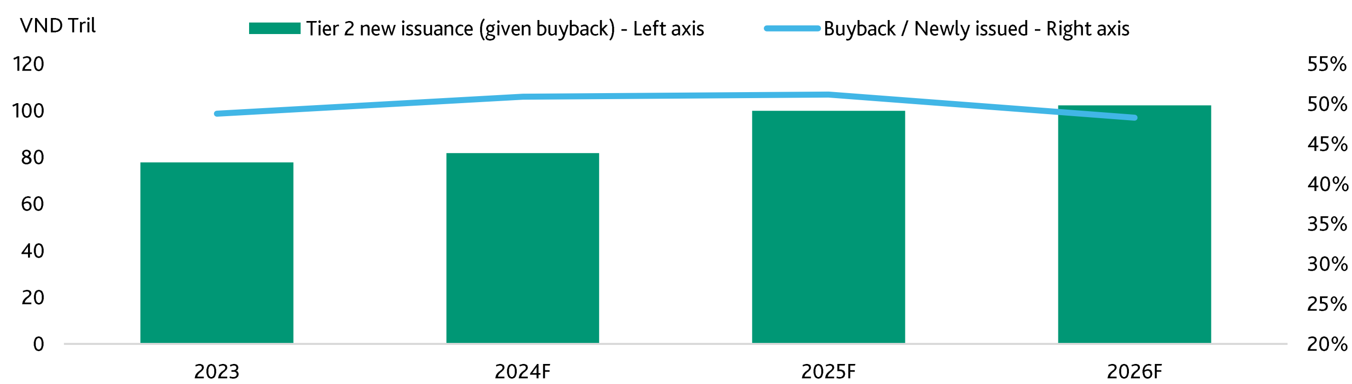
We expect the banking sector will need over 283 trillion VND of new subordinated bonds over the next 3 years

Majority of new subordinated bonds will be issued by SOBs, followed by several large and mid-sized banks with rapid loan growth and some small banks with weaker-than-peer profits

As credit growth picks up over the next 1-3 years, banks will need over VND283 trillion of new tier 2 capital (Exhibit 9) to supplement their internal capital generation and maintain stable capitalization.

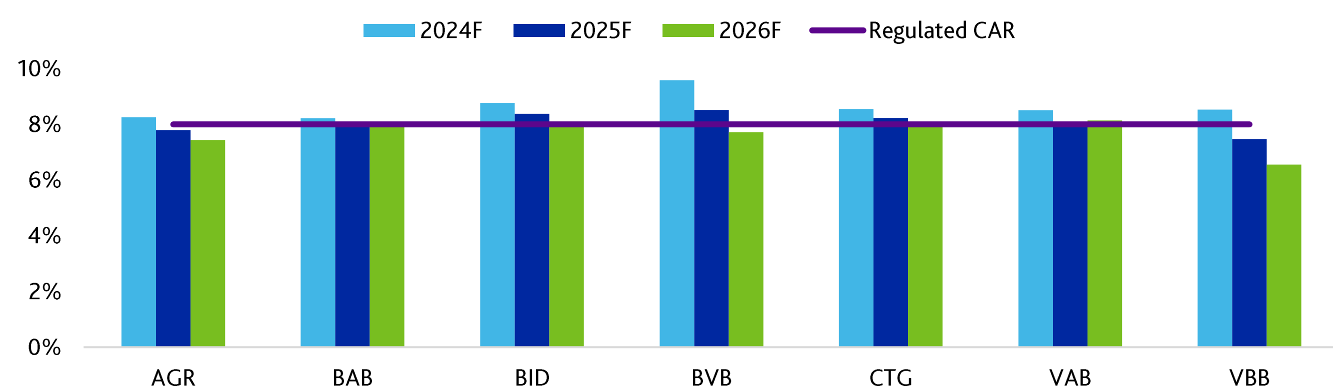
Bank profits will improve gradually, but without new capital, capital ratios will fall, particularly for the SOBs and several JCBs (Exhibit 10).

Exhibit 9: The banking sector will need over 283 trillion VND of new tier 2 bonds from 2024-2026



Source: HNX, Company data, Vietnam Investors Service

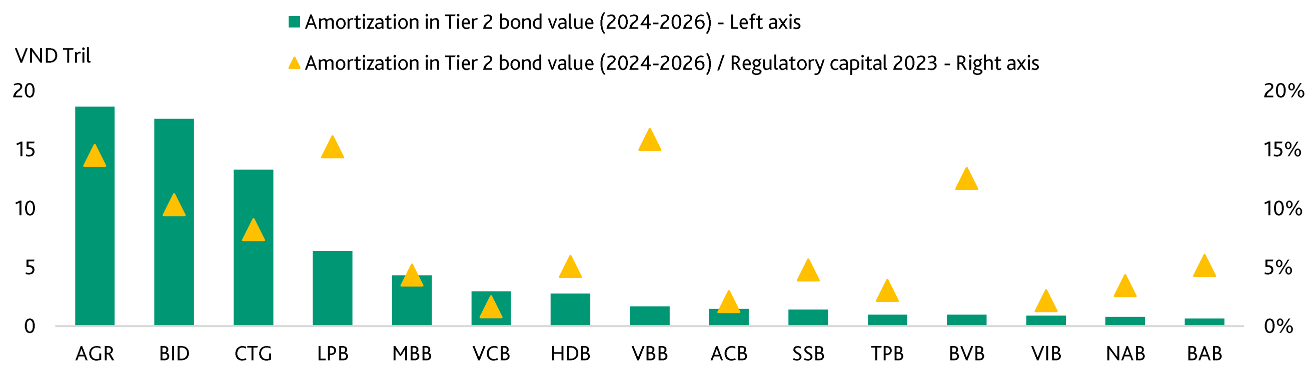
Exhibit 10: CAR of several banks will decline significantly given no new equity raising and tier 2 issuance



Source: Company data, Vietnam Investors Service
Note: Refer to the Appendix for the full name of the banks

Under local regulations, the amount of outstanding tier 2 bonds recognized as regulatory capital is reduced (i.e. amortized) by 20% per annum in the last 5 years of the bond tenor (Exhibit 11). Banks that are either working through asset quality issues or unable to raise new equity capital will need new tier 2 bonds. The new tier 2 bonds will help to replace existing ones that are amortized or redeemed early and/or support the growth in risk-weighted assets.

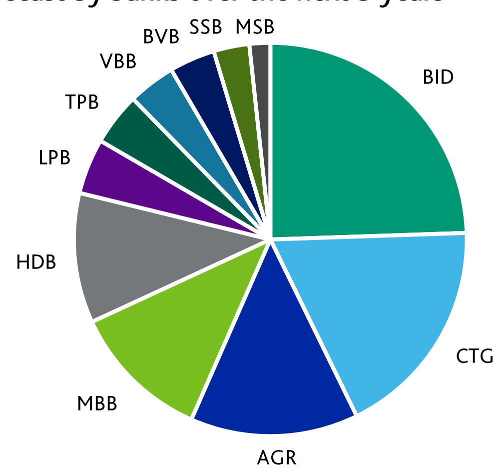
Exhibit 11: Amortization of tier 2 capital by banks and contribution to total capital from 2024-2026



Source: Company data, Vietnam Investors Service
Note: Refer to the Appendix for the full name of the banks

Over the next 3 years, we expect close to 55% of new tier 2 bonds will be issued by SOBs (Exhibit 12) due to the significant amortization of their outstanding tier 2 capital. A few small banks with weak profitability will also issue subordinated bonds to support their CAR by 3-4%. In addition, some mid-sized and large private banks will utilize subordinated bonds to support their strong credit growth.

Exhibit 12: New tier 2 issuance forecast by banks over the next 3 years



Source: Company data, Vietnam Investors Service
Note: Refer to the Appendix for the full name of the banks

As of the report date, several banks disclosed their plans to issue new tier 2 bonds in 1H 2024 (Exhibit 13).

Exhibit 13: List of recently disclosed new tier 2 bond issuance plan

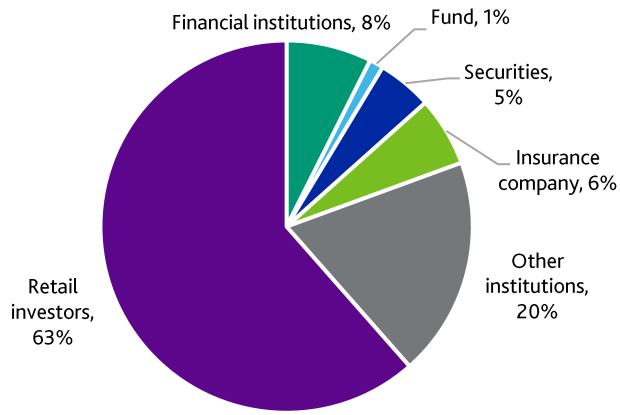
Banks	Timing issuance	Issue value	Bond type
BAB	From 2024 - 2026	VND 9 trillion	Tier 2
BID	From 6/2024 - 12/2024	VND 14 trillion	Tier 2
CTG	From 6/2024 - 11/2024	VND 8 trillion	Tier 2
HDB	In 2024	VND 20 trillion	Tier 2/Senior bonds
MBB	In 2024	VND 10 trillion	Tier 2
SHB	From 6/2024 – 12/2024	VND 5 trillion	Tier 2
VAB	In 2024	VND 1 trillion	Tier 2

Source: Company data, Vietnam Investors Service

We expect retail demand for tier 2 bonds will remain strong

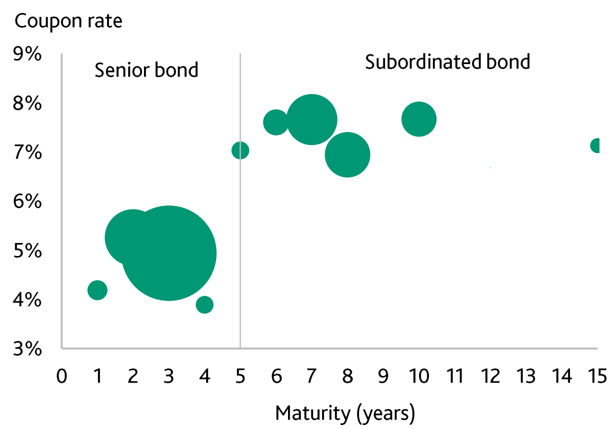
Retail investors hold on to the majority of the outstanding tier 2 bonds issued via public offerings today (Exhibit 14), largely due to the higher yields offered by these bonds relative to bank deposits and senior bonds (Exhibit 15). While banks typically hold onto a substantial amount of bank-issued bonds (Exhibit 16), they have less incentive to invest in tier 2 bonds of other banks due to the regulatory deduction of such investment amount from their regulatory capital.

Exhibit 14: 63% of the total public offering tier 2 bonds were held by retail investors



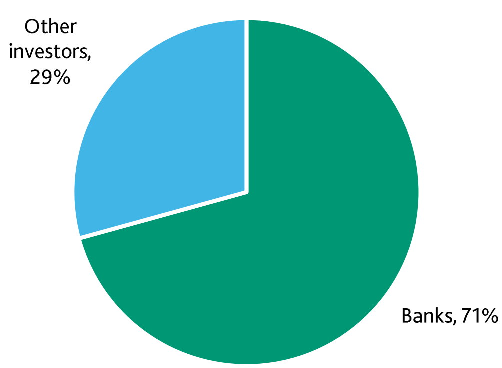
Source: HNX, Vietnam Investors Service
Note: Data comprised of BID, CTG, AGR, LPB, VBB, BAB's public subordinated bonds

Exhibit 15: Higher coupon rates relative to senior bonds



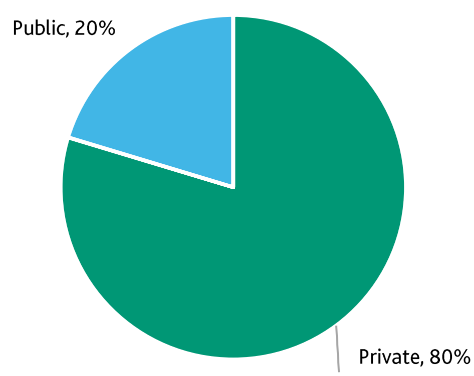
Source: Company data, Vietnam Investors Service

Exhibit 16: 71% of valuable papers issued by banks were invested by other banks as of 2023



Source: Company, Vietnam Investors Service

Exhibit 17: The majority of outstanding bank bonds were issued as private placements



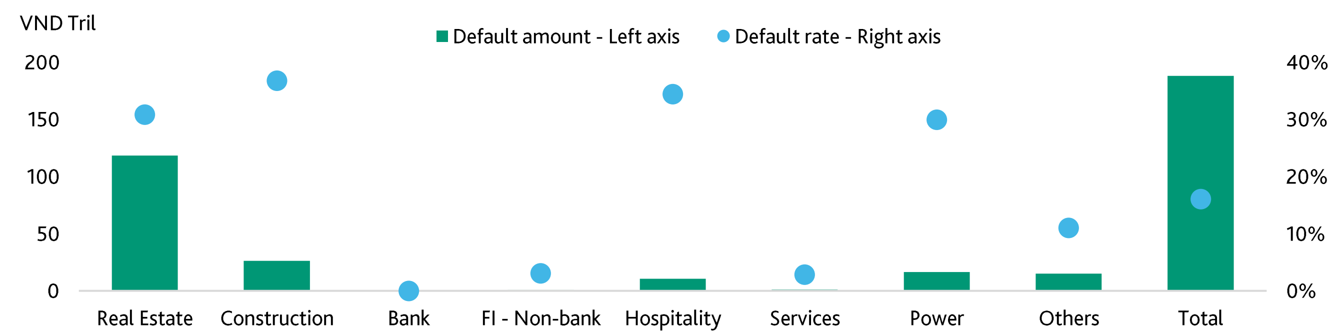
Source: HNX, Vietnam Investors Service

As shown in Exhibit 17, these bonds were mostly issued as private placements that, in the past, allowed issuers to complete their fundraising in shorter time frames and with minimal legal and documentary requirements.

We expect to see more tier 2 bonds issued as public offerings to tap the strong retail demand. This is because, under the new Decree No. 65, bond issuers can no longer sell private placement bonds to retail investors who are not accredited as professional investors.

The strong retail demand for tier 2 bonds is in part supported by the absence of defaults in bank-issued bonds (Exhibit 18) amid the surge in default rates in the corporate bond market[5].

Exhibit 18: No defaults have occurred for bank-issued bonds



Source: HNX, Vietnam Investors Service

Nevertheless, investors need to be aware of the investment risks of fixed-income instruments that are not backed by payment guarantees or insurance against payment delays and are prone to early redemptions. Exhibit 19 summarizes the differences in the key terms and conditions of some tier 2 and senior unsecured bonds, such as longer tenor, higher coupon, and coupon payment deferral.

Exhibit 19: Tier 2 bonds have longer tenor, higher coupon, and the coupon payment deferral feature

Term and Conditions	BID	CTG	BAB	ACB
Bond code	BID121027	CTGH2136002	BAB202201-07C	ACBH2123014
Type of bond	Subordinated bond			Senior bond
Maturity	8 years	15 years	7 years	2 years
Redemption/ Buyback	After 3 years	After 10 years	After 2 years	Negotiable
Coupon rate	» Floating rate, 0.9% margin » Margin step-up if not buyback	» Floating rate, 0.9% margin	» Combination of fixed rate and floating rate » Margin step-up if not buyback	» Fixed rate: 3.1%
Coupon deferral	Yes			No
Collateral	Unsecured			

Source: HNX, Company data, Vietnam Investors Service

[5] Refer to our Corporate Bond Market Review April 2024 (13 May 2024) and Corporate Bond Market Perspective: Building market discipline is critical to the sustainable growth of corporate bond issuance and slower defaults in the new development phase (27 Feb 2024).

APPENDIX

The banks included in our analysis are as follows:

	Short Name	Full Name	Classification
1	ABB	An Binh Commercial Joint Stock Bank	Small
2	ACB	Asia Commercial Joint-Stock Bank	Large
3	AGR	Vietnam Bank for Agriculture and Rural Development	State-owned
4	BAB	Bac A Commercial Joint Stock Bank	Small
5	BID	Joint Stock Commercial Bank for Investment and Development of Vietnam	State-owned
6	BVB	Viet Capital Commercial Joint Stock Bank	Small
7	CTG	Vietnam Joint-Stock Commercial Bank for Industry and Trade	State-owned
8	HDB	Ho Chi Minh City Development Joint Stock Commercial Bank	Mid-sized
9	LPB	Lien Viet Post Joint Stock Commercial Bank	Mid-sized
10	MBB	Military Commercial Joint Stock Bank	Large
11	MSB	Vietnam Maritime Commercial Joint Stock Bank	Mid-sized
12	NAB	Nam A Commercial Joint Stock Bank	Mid-sized
13	OCB	Orient Commercial Joint Stock Bank	Mid-sized
14	PGB	Prosperity and Growth Commercial Joint Stock Bank	Small
15	SGB	Saigon Bank for Industry and Trade	Small
16	SHB	Saigon - Hanoi Commercial Joint Stock Bank	Large
17	SSB	Southeast Asia Commercial Joint Stock Bank	Mid-sized
18	STB	Saigon Thuong Tin Commercial Joint Stock Bank	Large
19	TCB	Vietnam Technological and Commercial Joint-Stock Bank	Large
20	TPB	Tien Phong Commercial Joint Stock Bank	Mid-sized
21	VAB	Vietnam Asia Commercial Joint Stock Bank	Small
22	VBB	Vietnam Thuong Tin Joint Stock Commercial Bank	Small
23	VCB	Joint Stock Commercial Bank for Foreign Trade of Vietnam	State-owned
24	VIB	Vietnam International Commercial Joint Stock Bank	Mid-sized
25	VPB	Vietnam Prosperity Joint Stock Commercial Bank	Large

VIETNAM INVESTORS SERVICE