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Asian Development Bank

**PROJECT PREPARATORY TECHNICAL ASSISTANCE FOR
SME DEVELOPMENT PROGRAM LOAN – SUBPROGRAM II
– LEASING INVESTMENT LOAN
TA – 4781 (VIE)**

**Report
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The Consultants would like to extend their sincere appreciation for the assistance shown by the Government of Viet Nam during the implementation of the TA; specifically, the State Bank of Vietnam, the Ministry of Planning and Investment, the Ministry of Finance and the State Owned Commercial Banks (SOCBs) and their Leasing Subsidiaries as well as the private sector leasing companies and the Leasing Association of Viet Nam, who facilitated the Consultation Meetings, official dialogue and one-one due diligence.

The consultants wish to express their gratitude to the Government of Viet Nam stakeholders, the private sector leasing companies and to ADB for the enthusiasm and interest repeatedly demonstrated during the TA and without which, our work as Consultants would have been much less fruitful.

The results of the due diligence with the SOCBs, the leasing companies and the private sector leasing companies are confidential and will be submitted for the exclusive review of the State Bank of Vietnam, the supervisor and project executing agency, and the ADB - project financier.

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ABRIDGED

TABLE OF CONTENTS

	Page
A. Introduction	3
B. Structure of the Financial Sector	4
C. Structure of the Leasing Sector	7
D. Legal Environment	9
E. Examination of the Legal Environment for Leases	10
F. Detailed Participant Selection Process	13
G. Methodology for Selection Process	14
H. Capacity Building	15
I. Review of SME Demand	16
J. Summary of Requirements	17

APPENDIXES

1. Viet Nam Leasing Seminar: Powerpoint Presentation from ORIX Metro Leasing and Finance Corp " Developments of the Leasing Industry in Viet Nam – Lessons Learned from other Jurisdictions"	18
2. Viet Nam Leasing Seminar: Powerpoint Presentation from General Electric " Developments of the Leasing Industry in Viet Nam – Lessons Learned from other Jurisdictions: Tax Treatment of the Leasing Industry in SE Asia "	32

A. Introduction

1. The 2007-2010 Country Strategy Program (CSP) prepared by the Asian Development Bank (ADB) in close consultation with the Government of Viet Nam (the Government), highlights the rapid economic growth of Viet Nam. GDP growth has averaged 7.5 % per annum over the last decade, due to strong export performance (exports represented 61% of GDP in 2005), increases in the employment share of manufacturing and services sectors, and high inward remittances. It is estimated the private sector accounted for almost 90% of the 7.5 million jobs created in 2005, of which 64% were generated by Small and Medium Enterprises (SMEs). The CSP highlights the need for “the Government and ADB to focus on facilitating increased private sector investment and developing market institutions needed to promote competitiveness and create jobs”. It is expected that accession to WTO in January 2007 will facilitate sustained export growth and ongoing diversification in the manufacturing and services sectors as well as the ongoing development of the private sector. However, the financing constraints of SMEs need to be addressed in order to ensure the ongoing export and domestic-led growth of these enterprises as well as the ongoing absorption of new labor entering the market.

2. The World Bank Investment Climate Survey (2005) indicates access to finance to be a more significant constraint to enterprises in Viet Nam than to those in other countries. SMEs in Viet Nam have difficulty accessing financial services and securing financing which is mainly due to (i) a strong risk-adverse bias of the banks with respect to SME lending; and (ii) the absence of a diversified financial sector capable of servicing SMEs (especially lack of specialized financial institutions to provide loans for SMEs). Of the estimated 240,000 SMEs it is estimated less than one fifth has access to bank finance. Presently, loans to SMEs tend to be in the range of VND 1 to 2 billion (US\$62,000 to US\$124,000) for short maturities and are secured. It is reported that access to loans over VND 5 billion (US\$312,000) and medium and long term loans is very limited.¹

3. From a development perspective, a well functioning leasing industry is an important financing tool for SMEs. SMEs are particularly constrained by the lack of assets that can be used as collateral for bank loans. When credit is available from informal sources, it tends to be short-term and too costly for investment financing.² The advantages of leasing over alternative forms of finance for SMEs include: a lower down-payment – thus preserving enterprise working capital, availability, simpler documentation and security arrangements, and speed. In fact, leasing and supplier credit are often the only source of credit for investment available to SMEs especially those who have no real estate to offer as security or who have already borrowed the maximum against their real estate. By improving access to finance, leasing has a role in enterprise growth and employment generation. In turn, the development of lease companies should also support the development of inter-bank lending based on mortgage of lease receivables, as well as the eventual development of asset backed securities.

4. Internationally, a growing number of companies engage in leasing, including: subsidiaries of banks (as in Viet Nam) and bank holding companies, captive finance companies of industrial corporations, independent finance companies, and manufacturers and dealers providing financing for their products. Banks or their subsidiaries, provide

¹ VinaCapital Banking Sector Report August 15, 2006

² Between 2% to 5% per month. Source Finance Director of Duc Huy

leasing to make a profit, meet customer demand, protect their customer base, and develop new accounts.³

5. ADB has provided support in the area of financial and legal policy reforms, and is presently formulating the sub-sovereign/private sector investment project, in order to support the development of the leasing industry in Viet Nam. The Financial Sector Program Loan II (FSPL II) developed the initial legal and regulatory guidelines for the operation of financial leasing companies, and the SME Sector Development Program Loan (SDPL) formulated the concept of the Leasing Investment Loan to facilitate SME access to finance.

6. Over the second phase of the Technical Assistance (June to end-October 2007), ADB undertook additional advisory support to the leasing companies, Government stakeholders and the Leasing Association. The additional areas of proposed advisory support included (i) improved risk management – particularly with respect to upgrading the lease agreements, (ii) improved risk pricing of leases according to client risk and profitability targets of the leasing company(ies), and (iii) review modalities to streamline the legal inconsistencies within Decree 65 (65/2005/ND-CP) on repossession and between Decree 65 and the Judgment on the Enforcement of Contracts Law. (See paragraph 46 for specifics).

B. Structure of the Financial Sector

7. Viet Nam's financial system has seen a rapid growth in past decade and escaped the problems that many regional banking systems faced during the Asian financial crisis. The commercial banks dominate the sector with deposit mobilization growing by more than 28% per year⁴ and banking credit growing from 39% of GDP in 2000 to 66% in 2006⁵.

8. The formal financial sector at the end of 2006 was made up of 79 commercial banks, 7 finance companies and 11 financial leasing companies⁶. The commercial banks consist of 5 state owned banks (SOCB) with the remaining being either joint stock banks (JSB) 34, foreign bank branches 35 and 5 joint venture banks with foreign partners. The five state banks with their country wide network of more than 2000 branches and transactions desks account for the majority of the assets 68%, and 70% of the deposits as the end of 2005⁷. 2006 saw credit growth slowing from around 32% at the end of 2005 to around 25% by November 2006⁸ following a more cautious approach to lending by the SOCB's as they applied stricter underwriting standards. This was somewhat off-set by the JSBs which grew their lending (16% of the market at the end of 2005⁹) by nearly 40%¹⁰.

Table 1 Banking Sector Overview (end of 2005)

	Number	Assets Trillions	VND	Percentage of GDP
State-owned banks	5	610		73%
Joint Stock Banks	35	144		17%
Foreign bank branches and JV Banks	35	81		10%

Source: IFC Vietnam Financial Sector Diagnostic dated August 2006& World Bank Vietnam Data Profile

³ Peter K. Nevitt and Frank Fabozzi, *Equipment Leasing* (Published by Frank J. Fabozzi Associates, New Hope, Pennsylvania, 4th Edition, 2000) p. 61

⁴ Vietnam Development Report 2007, World Bank Dec 2006

⁵ Ibid

⁶ Intellasia (New Bank Licenses Pile Up) Oct 4th 2007.

⁷ IFC Vietnam Financial Sector Diagnostic dated August 2006

⁸ Vietnam Development Report 2007, World Bank Dec 2006

⁹ IFC Vietnam Financial Sector Diagnostic dated August 2006.

¹⁰ Vietnam Development Report 2007, World Bank Dec 2006

9. The Government initiated the restructuring of the SOCBs (2001 – 2010) and supported the transition from policy-based lending to commercial bank principles via a recapitalization plan of US \$670 million over the 2002-2004 period. This recapitalization plan is ongoing and involves both direct capital injection as well as authorization by Government for the SOCBs to issue bonds to improve Tier II capital.

10. The comprehensive reform measures and recapitalization programs, that included the upgrading of IT systems, as well as credit risk scoring applied to the large proportion of the corporate loan portfolios, has resulted in a marked improvement in the performance of the SOCBs over the 2004-2006 period. The NPLs and profitability indicators have improved year-on-year for Vietcombank, BIDV, Mekong Housing Bank and Incombank. Capital adequacy ratios have improved, Vietcombank, Mekong Housing Bank, BIDV and Incombank all indicate they now are in compliance with Basel I standards. Equitization is expected to further increase capital base. Most SOCBs have also completed 2006 financial audits according to international financial reporting standards but may only publish VAS version.

11. As a result of these improvements, Standard and Poor's have provided Vietcombank a BB/B rating, one notch below the sovereign rating. Fitch Ratings has also recently upgraded the four largest SOCBs to D/E from E.¹¹ The upgrade reflects the banks' shift to more private-sector lending and an overall improvement in profitability.

12. In order to improve the competitiveness of the financial sector, and also comply with WTO accession requirements with respect to opening the financial services market, the Government announced the equitization plans for all five SOCBs in 2005. It is expected the Government will retain majority share of at least 51%, in most of the SOCBs over the medium and long-term. The present equitization plans call for the sale of 30% of the shares in each major SOCB, to both the public and foreign strategic partners.

13. The Government has committed to the equitization of Vietcombank and Mekong Housing Bank in 2007; the Industrial and Commercial Bank of Vietnam and the Bank for Investment and Development of Vietnam in 2008, and Vietnam Bank for Agricultural and Rural Development in 2009. However it is likely only Vietcombank will complete the first phase of its equitization in 2007.

14. Vietcombank and the Mekong Housing Bank have each hired equitization consultants – these are respectively, Credit Suisse First Boston and Deutsche Bank. BIDV and Incombank have now also identified their advisors - these are Morgan Stanley Dean Witter Asia (Singapore), JP Morgan Securities Asia Pacific. BIDV has also selected White and Case as legal advisor.

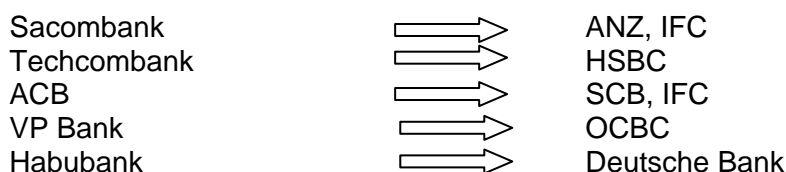
15. Presently the top five joint stock banks are Techcombank, Saccombank, Vietnam International Bank, Asia Commercial Bank, and East Asia Commercial Bank. The smaller JS banks include such banks as Habu Bank, Viet A Bank, and Saigon Bank.

16. While the number of JSBs has fallen from the peak of 51 in 1996, competition is expected to increase further with Viet Nam's recent accession to WTO, which allows for foreign banks to set up wholly owned foreign subsidiaries. It is reported that SBV expects to receive around 20 new applications for banks, from both large corporations and seven foreign banks. Among the applicants are Hong Kong Shanghai Bank Corporation (HSBC), Australia & New Zealand Banking Group Ltd. (ANZ), Standard Chartered Bank (SCB) and banks from Taiwan and South Korea. Vietnam Post and Telecom Group is also expected to set up its own joint stock bank.

¹¹ Fitch Ratings. 2007. Fitch Upgrades the Ratings of Vietnam's State-Owned Commercial Banks. Hong Kong. (2 May).

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17. The leading JSBs have also looked to strengthen their management through strategic alliances with internationally recognized banks.



18. The major joint stock banks have launched ambitious expansion plans. Over the last four years, Sacombank, Asia Commercial Bank (ACB), Techcombank have expanded their branch networks and now count up to 200 bank branches respectively (including sub-branches and transaction centres). Sacombank plan 350 outlets nation wide by 2010. To support this growth the joint stock banks are taking steps to strengthen their capital and during 2006 many increased their capital several time. The minimum capital held now being between US\$43.75-50 million with many having capital of over US\$62.5 million¹². Stock market reversals at the end of first half of the year stalled the plans of some JSBs to raise capital which could both slow their growth and potentially lead to mergers in this market segment. Furthermore, the upcoming IPO of SOCBs may bring more realism to the value of joint stock bank shares, potentially hampering their ability to obtain capital for expansion. However, in October Military Commercial Bank announced the sale of convertible bonds and ACbank announced it had issued VND 2.25 trillion in October maturing 2012 and planned another VND 4.25 by year end. The coupon was 0.5 per higher than the five-year government bonds. Eleven state-owned and joint stock banks purchased 89 percent of the bonds and three overseas investors the remaining 11 percent.

Table 2. Examples of JSB Profitability and Growth in 2006

Bank	2006 Pre Tax Profit	% Asset Growth
Asia Commercial Bank (ACB)	US\$42.9	83%
Saigon Thuong Tin Commercial Bank (Sacombank)	US\$34.0	71%

Source: Annual reports

19. The rapid growth and expansion in the retail/SME market are reflected in the financial statements that reveal year-on-year assets increased by 70% for Sacombank in 2006 and by 80% for ACB. The larger JS banks continue to show profit growth in 2007. For the first 9 months of 2007 ACBank pre tax profit VND 1.3 trillion (US\$ 81million) and Sacombank reported VND 1+ trillion (US\$62 million)¹³. Overall in the first eight month of 2007, JS bank loans grew by 45.5%, SOCB's by 40%, foreign banks 3.1% and JV banks 20.4% indicating much more aggressive growth in SOCBs.¹⁴

¹² Ministry of Finance Vietnams Banking System Feb 2007

¹³ Intellasia "Joint stock banks slowly muscle out big state brothers" Oct 13 2007

¹⁴ Ibid

Table 3. A Comparison of Leading SOCB and Joint Stock Banks

VAS Dec 2006 VND Billion	SOCBS			JS Banks	
	Vietcombank Audited	BIDV Audited	Incombank Management a/cs	ACBank Audited	Sacombank Audited
Assets	166,952 (US\$10.4b)	161,277 (US\$10.0b)	137,853 (US\$ 8.6b)	44,645 (US\$2.8b)	24,776 (US\$ 1.5b)
Capital	11,127 (US\$ 695m)	7,626 (US\$ 476m)	5,490 (US\$ 343m)	1,653 (US\$103m)	2,870 (US\$179m)
CAR	10.03%	9.10% (9.18% 1 st q '07)	11% ⁽¹⁾	10.9%	11.82%
Equity/ Assets	6.65%	4.70%	4.0%	3.7%	11.59%
NPLs	2.89%	11.92% (6.44% 1 st q '07)	1.38% ⁽¹⁾	0.19%	0.72%
ROA	1.7%	0.75%	0.53%	1.13%	1.9%
ROE	25.8%	14.11%	10.4%	30.56%	16.38%
Int. Margin	2.59%	1.87%	3.2%	2.15%	3.56%
Overhead Ratio	23.00%	34.20%	42.2%	32.31%	29.47%
Net loans to total deposits	55%	73.6%	73%	50.45%	71.42%

Source 2006 Annual Reports and Management Accounts

20. On a comparative basis, the return on assets (ROA) are similar for Sacombank, Vietcombank and ACB. With respect to return on equity (ROE), BIDV, ACB and Sacombank all had substantial increase in non interest income.

C. Structure of the Leasing Sector

21. The financial leasing companies with total assets of around VND 9 trillion comprise only a small fraction (1%)¹⁵ of the formal financial sector total.

22. Presently, there are eleven leasing companies operating in Viet Nam (Twelve when ACBank Leasing commences business on Oct 29th 2007). Leasing companies are licensed and regulated by the State Bank of Vietnam and are regarded as non-bank credit institutions under the Law on Credit Institutions. “Decree No 16/2001 ND/-CP of May 2, 2001” issued by SBV provided the broad legal framework for leasing operations. The decree authorizes only those financial leasing companies licensed by the State Bank of Viet Nam to undertake finance leasing transactions. The activities of leasing companies were initially restricted to financial leasing for machinery, equipment, vehicles, other moveable assets and other services related to financial leasing operations. The Government issued “Decree No 65/2005/ND-CP of May 19, 2005” amending Decree 16, to allow for operating leasing, sale of finance lease receivables and lease-back, and syndicated lease transactions. Decree 65 provides for a limit of 30% of all capital of a finance leasing company to be exposed to one client and also outlines the broad procedures for the enforcement of leasing contracts.

23. Parent banks are historical reluctant to lend to the subsidiaries of other banks. In the case of the leasing companies the opaque legal environment in the area of enforcement, further discourages lending institutions other than the parent banks to lend to leasing companies or buy lease receivables. This places a constraint on lending to the leasing companies, by an institution other than the parent bank and also restricts the ability for leasing companies to address the funding mismatch. Parent banks can provide credit without collateral to a subsidiary financial leasing company to a maximum of 5% of its capital.

¹⁵ Financial statements of the SOCB owned leasing companies and ADB estimates.

24. Market assessment results indicate the regulatory reforms have benefited the growth of the leasing sector in Viet Nam. The sector registered an annual growth rate of 50% over the period 2002–2004. Over this period, the lease balance in the finance leasing industry has grown from an estimated US\$160 million to US\$410 million. In the period to 2006 the growth slowed due to portfolio repositioning (resulting mostly from Government controls on new construction to curb speculation) and more prudent underwriting procedures enforced by most of the leasing companies. Lease balances at the end of 2006 stood at around US\$600 million with the SOCB leasing companies indicating they estimate growth rates of 20% year-on-year and Sacombank Leasing company indicating 100% growth.

25. Decree 16 establishes four types of financial leasing companies: State Run Financial Leasing companies of which there are 6, Joint Stock Financial Leasing Companies of which there is none, Affiliate Financial Leasing Companies and Joint Venture Financial Leasing Companies of which there are 3 and 2 respectively.

Table 4. Leasing Sector Overview (end-2005)

	Shareholder(s)
Affiliate Financial Leasing Companies of Credit Institutions	
Company	The Export Import Bank of Korea 100%
Chailease International Leasing Company	Chailease Finance Company Ltd Taipei 100%
Sacombank Leasing	Sacombank 100%
Joint-venture Financial Leasing Companies	
ANZ /V-TRAC Leasing	ANZ Bank , Caterpillar Equipment
Vietnam International Leasing Company	Industrial & Commercial Bank of Vietnam, Natexis, KDB Capital Corporation, Aozora Bank
State Run Financial Leasing Companies	
Vietcombank Financial Leasing Company	Vietcombank
Industrial and Commercial Bank of Vietnam Leasing Company	Industrial and Commercial Bank of Vietnam
Vietnam Bank For Agriculture and Rural Development Financial Leasing Co I	Vietnam Bank For Agriculture and Rural Development
Vietnam Bank For Agriculture and Rural Development Financial Leasing Co II	
Bank for Investment and Development of Vietnam Financial Leasing Co I	Bank for Investment and Development of Vietnam
Bank for Investment and Development of Vietnam Financial Leasing Co II	

26. The two subsidiary leasing companies of the Vietnam Bank for Agriculture and Development (VBARD) and the two subsidiary companies of the Bank for Investment and Development of Vietnam (BIDV) with offices in Ho Chi Minh and Hanoi, together account for over 60% of market share. The other public leasing companies, that are part of state-owned commercial banks of Vietnam, include the: Vietcombank Leasing Company, the Leasing Company of the Industrial and Commercial Bank of Vietnam (Incombank) account for 16%. The 6 private sector leasing companies, are: the Vietnam International Leasing Company, the Sacombank Leasing Company, KEXIM Vietnam Leasing Company, ANZ/V-TRAC, Chailease International Leasing Company¹⁶ and the recently formed ACB Leasing Company¹⁷ share the remaining 24% of the market¹⁸. It is expected that foreign invested

¹⁶ Company's figures not available

¹⁷ Operations to commence Oct 29 2007

joint stock banks will continue to develop their leasing facilities to participate in the growing market.

Table 5 Leasing Market Share (May 2007)

Company	Asset VND Thousands	Market Share
ANZ	41,774	0.44%
VBARD I	1,282,529	13.64%
VBARD II	3,548,998	37.75%
BIDV II	498,542	5.30%
KEXIM	799,259	8.50%
BIDV I	980,209	10.43%
INCOMBANK	594,771	6.33%
VIETCOMBANK	945,043	10.05%
SACOMBANK	192,000	2.04%
VILC	517,157	5.50%

Source SBV

D. Legal Environment

27. It is noted that the legal and regulatory environment supporting the development of the financial sector, is currently being upgraded. The following major laws are currently being drawn:

- Audit Law
- Law on Deposit Insurance
- Law on Credit Institutions
- Law on State Bank of Vietnam

28. These laws will further enhance the legal environment in the financial sector by adding transparency of process in respect of audits, provide the framework for credit insurance, and modernize the establishment of commercial banks to bring it into line with the Enterprise Law. Significantly, the Financial Inspections Law will upgrade the powers of the credit institution inspection regime from a decree to a law. The Securitization Law will expand legal regime in respect of securitization, providing for a more certain system of registration and dealing with certain securities, including leases receivables.

29. Leasing requires a supportive legal environment to facilitate (i) the establishment of financial and operational leasing companies, (ii) the formation and registration of leasing contracts, (iii) the regulatory regime, (iv) a securities market, and (v) fund raising. Viet Nam has such a regime in broad terms and is in the process of strengthening the enabling environment.

30. Dispute resolution is a vital part of any legal environment provided by the State. It is a tool to be used in (i) recovery of assets, (ii) to assert rights in respect of collateral security, (iii) to sue to resolve any disputes and (iv) to recover losses incurred on an agreement. Dispute resolution includes the courts and the ability to enforce the orders of the court. Viet Nam has an Economic Court, but enforcement of its judgments is difficult. There seem to be some practical implementation difficulties as appeals can take 10 years to resolve.

¹⁸ The International Finance Corporation recently divested from the Vietnam International Leasing Company (joint equity investment with Incombank, Natexis, KDB Capital Corporation, Aozora Bank) to review the potential activities in the sale of lease receivables, and has taken equity participation in Sacombank. Sacombank recently formed its leasing company. The third private leasing company, ANZ/V-TRAC, is the fully-owned subsidiary of Caterpillar equipment and the fourth, KEXIM Vietnam Leasing Co, is the subsidiary of the Korea Export Import Bank. Chailease is a subsidiary of Chailease Finance Company Limited of Taiwan.

E. Examination of the Legal Environment for Leases

31. The Decree on the Organization and Operation of Financial Leasing Companies No 16/2001/ND-CP of May 2, 2001 (as amended) (Decree 16) and by Decree No 65/2005/ND-CP of May 19, 2005 (Decree 65) form the basis for the formation, operations, and governance of financial leasing companies. In general terms, the Decree is adequate.

32. The assets that may be the subject of a financial lease are limited to tangible assets only and do not contemplate intangible assets

33. It is unclear whether foreign investors can purchase and deal in receivables; this requires clarification as it will inhibit the development of a secondary market. It is also unclear whether the holder of receivables contract has rights of subrogation back to the lessee.

34. **Rescheduling of Leases.** Rescheduling of leases requires additional and supporting attention from the inspectors of the State Bank of Vietnam (SBV). By way of illustration, while there is a requirement that financial leasing companies notify of any changes to procedure in their rescheduling policy, there is no actual requirement that they have such a policy. This is inferred. Furthermore, the financial leasing companies use and adopt the rescheduling policies of their parent banks in respect of non-performing loans. The structure of a lease is different from a short or medium-term credit as is the underlying risk and collateral taken by the leasing company. This situation requires attention to facilitate the sustainable and prudent growth of the leasing sector.

35. **Recovery of Leased Assets by Self Help.** Article 28 of Decree 65 (defined as “the Decree above”), provides for the recovery of assets through the use of self help by the financial leasing company. In this regard, its provision is appropriate. Training in respect of the operation of new laws is important and often overlooked in most jurisdictions in the world. Lack of training is extenuated in a developing economy where the systematic review of the laws may be subject to greater financial and human resource constraints. Following the recommendations of the consultants made in the Report of May 2007, the SBV has met this identified problem through the Joint Circular No.08/2007/TTLT-NHNN-BCA-BTB. “Providing the guidance on repossession and settlement of lease assets of financial leasing company”.

36. **Evidentiary Matters in Respect of Debts Owed to Leasing Companies.** To facilitate the operation of Decree 65, the draft circular could additionally provide that - in any action taken by a finance leasing company for the recovery of debts due under the lease and any other loss, the lessee is bound by a certificate of indebtedness, given by the head accountant of the leasing company, as to the amount outstanding, including costs, under the lease, unless it is proven by the lessee to be in error. This would address a problem of proof that is met by finance leasing companies when attempting to recover debts by realizing on secondary security or through an action in court. A provision to this effect has been drawn to be included in a generic form of lease drawn by the consultants.

37. **Prudential Limits.** Article 30 most properly provides for the maintenance of prudential limits as contemplated in the Law on Credit Institutions, as administered by the SBV. It also provides for a limit of 30% of all capital of a finance leasing company to be exposed to one client. This is a necessary control to limit concentration.

38. **Inspection.** The Inspection Branch of SBV has a reasonably comprehensive jurisdiction in respect of its inspections. The sanctions regime at its disposal is apparently ultra vires in respect of revocation and suspension of licenses. This is a matter that should

be addressed in the new Law on Inspection, as it will more fully provide for the powers of the inspectors. SBV is moving from transactional inspection to risk based inspection. It has advised that it requires additional capacity building in respect of this transition. The administrative sanctions also may need to be strengthened to ensure greater deterrence and improved market discipline on operation of leasing companies.

39. Once the leasing companies are equitized and thus no longer in receipt of government guidance at the same level as currently received, the motivation of the entities will be primarily that of profit. Clarification of the sanction regime will be of assistance in ensuring that the regulations are complied with in all respects under the evolving business procedures and marketing strategies of the leasing companies.

40. **Consumer Protection.** Decree 65 and the entire legal regime concerning leases and credit institutions generally contain limited provisions for consumer protection. Consumer protection provisions should ensure that lessees and guarantors understand in a clear, non technical and unambiguous manner, the liabilities and obligations that they are incurring before they enter into an agreement. This empowers people to make choices as to the personal cost and exposure that may have by entering into the agreement. They may then decide whether or not to proceed with a transaction. This is of advantage to both the credit institution and the consumer, as the credit institution will not have the same risk of loss through a possible NPL as it might have, and customers are able to fully assess the obligations and whether they can be easily met. The consultants have drawn a document to provide information concerning the rights and obligations of lessees under a financial lease. The draft generic forms of lease for private companies and individuals contains an acknowledgment that this document has been provided to the lessee and guarantors prior to the client entering into the lease. Once a decision has been made to enter into a contract there are adequate and proper laws regulating the conditions of contracts, liabilities and obligations of contracting parties and penalties for breaches. Refer to the Civil Law, the Law on Credit Institution, Decree No. 65 and Decree No. 16/2001/ND-CP of May 2, 2001.

41. **Implementing Circular for the Decree 65.** Circular No. 06/2005/TT-NHNN, the Implementing Circular for Decree 65 (the Implementing Circular) is a competent document closely following the provisions of the Decree. Its provisions in respect of the scrutiny of those who are involved in the management of finance leasing companies are appropriate and in general terms consistent with best practice.

42. **Trust Services.** Trust services can be provided by financial leasing companies. Circular No. 05/2006/TT-NHNN of 25 July 2006 provides some provisions in respect of financial leasing activities and financial leasing trust services, including, the regulation of trust services, the scope of operations, principals, contracts, risk settlement and liabilities and obligations of trustees and settlers. However, there is a lack of specific detail in respect of the obligations of trustees and the rights of those who use such services. This must be rectified so that in the event of a dispute, the parties have certainty as to their rights and obligations. Without such guidelines there is no certainty and dispute resolution, either before the courts or other dispute resolution mechanisms may be significantly constrained.

43. **Repossession, Enforcement and Recovery Rights and Risk Management.** Financial leasing companies advise that the greatest problems that they encounter relate to repossession and the recovery of indebtedness from lessees. The right of self-help for a lessor to regain possession of its assets is axiomatic, as the assets are their property and any right to possession of a lessee terminates immediately upon breach of the terms of the lease.

44. Financial leasing agreements are essentially to provide for the management of risk for the lessor. They should provide for all the legal weapons possible for use in aid of the recovery of a leased asset in the event of default and the unwillingness by a lessee to surrender of the asset to the leasing company. The current agreements used by the financial leasing companies do not maximize the rights of the financial leasing companies and require to be redrawn.

45. **Court Proceedings.** Court proceedings are generally not regarded by the leasing companies as being of great assistance in respect of repossession or enforcement of debt recovery. The Economic Court, whilst being assigned as a specialist court, does not have specialist judges assigned to it.

46. **Enforcement of Court Orders.** The Enforcement Branch of the Ministry of Justice is constrained to enforce judgements in a timely way due to the large number of cases for review and the limited number of trained commercial judges.

47. The largest problem in respect of enforcement for leasing companies is the conflict between the legal right, as perceived by the Enforcement Branch, of a person/lessee to retain the means of production and the right of the owner/lessor over that means of production. This subrogates the ownership rights of the lessor but is based on an error of legal interpretation. The lessor may be left with reduced or no residual value in the asset, as it cannot gain access to it for its realization.

48. **The Bankruptcy Law.** The need to have an effective bankruptcy system is vital in a market economy, as it provides unsecured or partly secured creditors with an opportunity to recover some of their debts. The Law on Bankruptcy is an additional tool in the armory of a financial leasing company to assist it in the recovery of debts without the need to obtain a judgment from the courts in respect of an unsecured part of any debt from a lessee. This law is little used. This law is appropriately drawn, supported by an adequate implementing decree. There are deficiencies in respect of the relation back period and the composition of the property management and liquidation teams. The Economic Court requires expert bankruptcy judges with appropriate training in this area.

49. **Registration of Lease Agreements.** Registration of lease agreements allows for maximized protection from fraudulent dealing, but not a guaranteed protection. The system is largely functional. The fields of registration require expansion to include serial numbers wherever possible to minimize third party fraud.

50. The provision for compensation in the event of an error on the register is entirely inadequate, as it provides for the civil servant responsible to make payments of compensation. There is no apparent right to compensation in the event of erroneous information being provided during a search if the register was correct, but the reporting of it was not.

51. Complete computerization of the registration system is justified. The regulatory regime is being upgraded into law.

52. **Generic form of Lease Agreement.** The consultants have drawn three forms of generic lease. They are adapted to individuals, private companies and public companies. They are drawn to assist with basic risk management and to enhance to rights of self-help in the event of default by a lessee. A power of attorney is included to assist in the maximization of assertion of rights by a lessor and to ensure that there is ease of transfer of all registrations and authorization in the event of a sale of a previously leased asset.

53. Next Steps.

- Undertake intensive training of the modalities of repossession following the promulgation of the new circular “Providing guidance on repossession and settlement of lease assets of financial leasing company”. This training should adopt an holistic approach and include not only the officers of the leasing companies, but also judges of the Economic Court and strategic enforcement officers of the Ministry of Justice.
- Review the proposed amendments to Decrees 16 and 65 to comment upon their inclusion or adoption or otherwise of international best practice
- Assistance to the Economic Court by the provision of training in respect of the commercial laws, in particular those dealing with the financial sector
- Provide specialist training to judges of the Economic Court and members of the legal profession in respect of the operation of the Bankruptcy Law, and develop manuals for the courts, legal and accounting professions in respect of bankruptcy, bank and leasing recovery and realization actions in respect of both non performing leases and loans
- Consider the amendment of the Bankruptcy Law to replace the property management and liquidation teams with expert administrator and liquidators, particularly in respect of bankruptcy of medium to large enterprises
- Review the legal impediments to the development of the financial sector generally, but including impediments to the giving of security over land
- Review of the laws and regulations concerning the enforcement of judgments
- The implementation of the circular on enforcement once it is approved

F. Detailed Participant Selection Process

54. A review of the two groups (SOCB owned leasing companies and non SOCB owned leasing companies) indicated that the SOCB leasing companies are best placed to advance ADBs objective of expanding lease financing to SMEs and it is recommended that the participants should come from this group.

55. Their present market share is already around a round 90% and while their branches with the exception of Agribank are presently restricted to Hanoi and HCMC they have leasing officer teams that cover the whole country. They also cover a wide number of industries.

Table 6 Industries Served end -2006

Industry	Amount VND millions	%	Industry	Amount VND millions	%
Trading/ Services	2,001	26%	Transport, Warehouse & Distribution	659	9%
Construction	1,484	20%	Vehicles (Trading & repair)	339	5%
Processing	956	13%	Others (e.g. Metallurgy, mining, utility distribution, agriculture)	974	13%
Shipping	769	10%			
Financial	392	5%			

Source: Segmentation data provide by SOCB leasing companies and ADB manipulation

56. Their willingness and interest to expand their SME leasing operations is clearly demonstrated as over 75%¹⁹ of their leases are already granted to SME companies. Also with the average exposure per lessee of around VND 1.4 billion (US\$88,000)²⁰ they are providing leases of the size suitable for SMEs whose average capital in 2005 was around VND 2.7 billion (US\$170,000).

G. Methodology For Selection Process

57. The Government of Vietnam was explicit in stating they wish the loan to be sub sovereign thus both the leasing companies and the parent banks must meet ADB private sector risk criteria. ADB's risk criterion requires the demonstration of sound and prudential financial performance of the company. The key indicators of this are seen to be the quality of the assets, the profitability and the capital adequacy of the borrower.

58. To meet ADB's risk criteria and in attempt to be equitable in selecting the preferred participants a ranking system was developed that took into account both financial and non financial criteria of the leasing companies. The ranking is weighted towards areas that ADB's risk management system places priority on.

59. It will be observed that the criteria most heavily weighted are financial performance, corporate governance and risk management. Within financial performance asset quality and profitability are given prominence.

60. Being sub sovereign, the borrowers must meet the criteria for ADB's private sector loans. Thus the need to demonstrate a history of maintaining high quality assets and good profitability providing the source of the loan repayment are paramount.

61. The methodology applied was that within the criteria illustrated above there were approximately 60 sub criteria. The companies were ranked from one to six in each sub criteria, 6 being the highest, and the ranking was multiplied by the weighting to provide an overall ranking. The financial ranking was based totally on objective measurements and to the extent possible, so was the non financial ranking. For example whether the directors were seated full time or not in the company's premises was taken as a proxy for the separation of the directors and management.

62. Given the history of the companies and that they are all owned by SOCBs, who again have a similar history, it is not surprising that there were many similarities between the companies in the non financial criteria. Thus the financial criteria where there were differences in the performance of the companies, became the driver behind the selection of the preferred companies.

Table 8 Non financial activities addresses in interviews

• Risk Management	• Audit Process
- Credit Policies and Procedures	• Governance
- Lease Disbursement and Documentation	- Provisioning
- Portfolio Management	• Business Strategy
- Credit Administration	- Customer Relationship Management
- Credit Recovery	
- Operations	
- Treasury/ ALM	

¹⁹ Segmentation data provide by the SOCB leasing companies

²⁰ SOCB leasing company supplied financial statement and customer number

H. Capacity Building

63. Training was conducted in both legal and financial issues in 20 sessions with in excess of 300 participants. In addition, detailed presentations on the tax and accounting treatment of operational and financial leasing in South East Asia were made by experts from Orix Metro Leasing and Finance Corporation and General Electric in Hanoi, Viet Nam during a seminar co-organized by ADB and State Bank of Vietnam in March 2009 (refer to Appendices 1 and 2).

Module	Content	Venue	Participants
Legal Framework for Leasing	<ul style="list-style-type: none"> • Legal requirements of leasing companies • Legal tools for dealing with defaulting lessees 	Hanoi SBV	Offices from SBV, various ministries, the SOCB leasing companies and JS bank leasing companies
SME Access to finance through leasing	<ul style="list-style-type: none"> • Case study of successful regional leasing companies • Proposed financing models for leasing companies 	Hanoi SBV	Offices from SBV, various ministries, the SOCB and JS bank leasing companies
		Hanoi Vietcombank Leasing Co	Marketing officers from Vietcombank Leasing Co
		HCMC Vietcombank Leasing Co	Officers from Vietcombank Leasing, ACBank Leasing & Saccombank Leasing
Corporate Governance	<ul style="list-style-type: none"> • Principles of corporate governance • Component bodies of corporate governance & their composition & responsibilities • Board and management committee roles & responsibilities 	Hanoi SBV	Offices from SBV, various ministries, the SOCB leasing companies and JS bank leasing companies
		HCMC Vietcombank Leasing Co	Officers from Vietcombank Leasing, ACBank Leasing & Saccombank Leasing
Risk Pricing & Product Pricing	<ul style="list-style-type: none"> • Theory of risk pricing • Building a product pricing model 	Hanoi SBV	Offices from SBV the SOCB leasing companies
		HCMC Vietcombank Leasing Co	Officers from Vietcombank Leasing & ACBank Leasing
		HCMC Saccombank Leasing Co.	Management & officers from Saccombank Leasing Co
Managing Lessee	<ul style="list-style-type: none"> • Practical sales skills • Identifying, acquiring and maintaining customers • Executing account plans • Monitoring customer relationship • Sales exercise (Proactive sales skills - role playing) 	Hanoi SBV	Offices the SOCB leasing co's
		HCMC Vietcombank Leasing Co	Officers from Vietcombank Leasing & ACBank Leasing
		Hanoi Vietcombank Leasing Co	Marketing officers from Vietcombank Leasing Co
		HCMC Saccombank Leasing Co.	Management and officers from Saccombank Leasing Company
Upgrading of Lease Agreements	<ul style="list-style-type: none"> • The need to change • Practice of self help • Explanation of clauses and covenants 	Hanoi Vietcombank Leasing Co	Senior Management
		Hanoi BVAR D Leasing Co	Senior Management
		Hanoi Incombank Leasing Co	Senior Management
		Hanoi Agric. Bank Leasing Co	Senior Management
		HCMC Saccombank Leasing Co	Management and officers from Saccombank Leasing
Overview of ALM & Duties & Activities of an ALM Committee	<ul style="list-style-type: none"> • Introduction & glossary of terms • Review of main risks • Overview of data collection • Composition and roles and responsibilities • Support requirements 	Hanoi SBV	Offices the SOCB leasing co's
		HCMC Vietcombank Leasing Co	Officers from Vietcombank Leasing, ACBank Leasing & Saccombank Leasing

I. Review of SME Demand

64. Characteristics of the companies (10 companies interviewed)
- Usually a factory and office at two different sites. Largest number of factories operated was 3
 - Exports ranged from zero to 20% of sales. One company sold to many exporters
 - Revenue averaged approx VND30 billion without the lowest VND5 billion and the highest VND100 billion
 - Assets (excluding real estate) averaged VND10 to 30 billion excluding 3 companies with assets of less than VND3 billion
 - Average number of employees 46, without the 2 largest companies 2,000 (garments) and 400 employees
65. Banking relationships
- Main banks were a mix of SOCBs and JS banks with no dominant bank. 3 of the companies used the smaller JS banks
 - One bank is normally dominant but companies have relationships with more than one bank (normally small loans)
 - Banks selected usually for convenience or because of prior relationships (pricing always major factor)
 - Normally required real estate as collateral, one company borrowed unsecured on strength of relationship and financial position
 - Loans to purchase low ticket machinery up to VND0.5 billion available with 50% deposit from many banks
 - Loans for large ticket items usually not available without real estate
 - With exception of construction company and one very small company other banks were soliciting them
 - One or more JS banks had called on 7 of the companies while SOCBs had called on 4 companies
 - Only on one occasion had a bank offered to introduce its leasing company
66. Leasing company relationship
- Four companies introduced by the leasing company used financial leasing from various leasing companies
 - Five companies that did not lease had never been solicited by a leasing company
 - Leasing companies had not solicited the business from those companies that were leasing
 - One company director had a knowledge of leasing and visited a number of leasing companies
 - Two company directors had friends who worked for leasing companies
 - Where non SOCB/JSB leasing companies used the introduction had been through the supplier
 - One SOCB bank introduced its leasing company
 - The deposit required by the non SOCB/JSB leasing companies were lower than the banks. (We surmise that as the supplier introduced the company to the leasing company the supplier may be sharing some of the credit risk)
 - One company, the construction company, sometimes rent but did not lease
 - One company, a medical supply company, rented out equipment to hospitals
 - The three larger companies that presently had financial leases said they depended on leasing to expand/ purchase new equipment
 - Bank line full leasing was the only way to purchase new equipment

- One company building a large new factory said it could fund the factory through its own funds and selling shares to the companies it supplied but was dependent on leasing for the equipment.

J. Summary of Requirements

67. Demand for leasing for the traditional reason that the only security required is the asset financed, is present. Reports already mentioned above have indicated lack of bank financing for SMEs. The small survey conducted by the project indicated that those companies already leasing could not have expanded to the extent they have without it and that future expansion will be dependent on lease financing available.

68. The growth of the industry is restrained by a number of factors most of which but not all are in the control of the leasing companies and their parents.

69. The one factor restraining growth that the leasing companies do not control is repossession. Action is being taken by SBV to make the process easier but only education of the judges and other officials involved in the process will provide a full proof solution. In the meantime the leasing companies can take steps to reduce the risks:

- Closer association with supplier will aid valuation of the item to be repossessed and its marketing
- Leasing companies not to finance one off assets which are used by a very limited number of companies
- Leasing officers to develop above average knowledge of certain industries so that they have a better understanding of the equipment it use

70. Factors the leasing companies do control, relate to organization and marketing.

- Marketing in the widest sense of educating SMEs that leasing is an alternative source of funding to bank loans.
- Ensuring that sufficient marketing officers are available to manage existing customers and develop potential customers, our impression is that:
 - Most SOCB leasing companies do not have sufficient dedicated marketing officers. (This comment relates just to marketing officers not to overall staffing). JSB leasing companies appear to have many more marketing officers than SOCB leasing companies allowing each marketing officer to be responsible for lower number of customers.
 - Marketing officers should be dedicated to customer care of potential customers and performing customers. Non performing lessees should be handled by specialized units – this model seems to be considered industry best practice.
 - Marketing officers should have assistants to handle routine tasks such as data entry and initial preparation of lease proposal.
- Customers existing and potential should be allocated to marketing officer in accordance with a planned framework: type of industry, geographical location of customers, number of customers and amount of work to be managed by an individual marketing officer.
- Marketing officers should have measurable targets by which to judge and reward their performance.

“Developments of the Leasing Industry in Vietnam.

Lessons learned from other jurisdictions.”

State Bank of Vietnam
Hanoi, Vietnam
March 17, 2009

Mr. Ding Bantayan, Jr.
Executive Vice President
ORIX Metro Leasing and Finance Corp.

PRESENTATION OUTLINE:

- A. Drivers to Growth of Leasing
- B. Financial Lease vs. Operating Lease
- C. Types of Leases
- D. Stages of Development of Leasing in the Philippines
- E. Interactions with Government Regulatory Agencies
- F. The Asian Leasing & Finance Association (ALFA)

A. DRIVERS TO GROWTH OF LEASING

1. Selling Techniques

- Tailor fitting the product to client's needs
 - Tax timing difference
 - Balance sheet management
 - Capital conservation
 - Flexible payment terms
- Use of advertising medium (e.g. print advertisements)
- Participation in Trade Fairs
- Partnership with Dealers or Vendors
- Sponsorships of leasing seminars to educate market

A. DRIVERS TO GROWTH OF LEASING

2. Funding Techniques

- Application for Quasi-bank license
 - Existing Law limits no. of lenders to only 19
- Assignment of Lease receivables
- Affiliation with banks
- Others

3. Cost Containment

- Outsourcing of services

A. DRIVERS TO GROWTH OF LEASING

4. Use of Technology

- Development of integrated computer systems
 - May be developed internally; or
 - Solutions offered by independent firms
- For full service operating lease, use of following:
 - Internet based real time vehicle management system
 - Environment data support service
 - Refueling administration system
 - Electronic toll collection cards
 - Driver diagnostic system
 - 24/7 safety service
 - Telematics via GPS technology

A. DRIVERS TO GROWTH OF LEASING

5. Taxation

- Finance Leases – Gross Receipt Tax (GRT)
- Operating Leases – Value Added Tax (VAT)

A. DRIVERS TO GROWTH OF LEASING

6. Accounting System

- Finance Leases

Lessor / FI

Income Statement

Credit	Debit
Interest Income	

Balance Sheet Statement

Credit	Debit
	Lease Contract Receivables
Unearned Leasing Income	

Lessee / Client

Income Statement

Credit	Debit
	Interest Expense
	Depreciation

Balance Sheet Statement

Credit	Debit
	Asset (e.g. Equipment)
Liability (Payable)	

A. DRIVERS TO GROWTH OF LEASING

6. Accounting System

- Operating Leases

Lessor / FI

Income Statement

Credit	Debit
Rental Revenue	
	Depreciation Expense

Balance Sheet Statement

Credit	Debit
	Asset (Equipment)

Lessee / Client

Income Statement

Credit	Debit
	Rental Expenses

Balance Sheet Statement

Credit	Debit
Off balance sheet	

A. DRIVERS TO GROWTH OF LEASING

6. Accounting System

- IAS 17 (revised)

“A lease is classified as a finance lease if it transfers substantially all the risks and rewards incident to ownership. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incident to ownership.”

- Examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are:
 - (a) *the lease transfers of ownership of the asset to the lessee by the end of the lease term;*

A. DRIVERS TO GROWTH OF LEASING

- Examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are (cont.):
 - (b) *the lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it be reasonably certain, at the inception of the lease, that the option will be exercised;*
 - (c) *the lease term is for major part of the economic life of the asset even if title is not transferred;*
 - (d) *at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and*
 - (e) *the leased asset are of such a specialized nature that only the lessee can use them without major modifications.*

FINANCE LEASE vs. OPERATING LEASE

ADB



B. FINANCIAL LEASE vs. OPERATING LEASE

	Finance Lease	Operating Lease
(a) Documentation:		
- Cancellable	No	Yes
- Option to Buy	None	None
(b) Residual Value Risk	Lessee	Lessor
(c) Rental Composition	Interest + Principal	Interest + Principal + Maintenance + Insurance + Registration Fleet Mgt.
(d) Leased Asset:		
- Highly Specialized	Allowed	Not Allowed

ADB



B. FINANCIAL LEASE vs. OPERATING LEASE

1. Point of View of Lessor:	<u>Lessor Books</u>	<u>Lessor Books</u>
(a) Balance Sheet Statement		
- Leased Assets	Receivables	Leased Assets Depreciates Assets
(b) Income Statement		
- Revenues	Interest Portion only	Total Rental
2. Point of View of Lessee:	<u>Lessee Books</u>	<u>Lessor Books</u>
(a) Balance Sheet Statement		
- Leased Assets	Asset and Liability Depreciates Assets	Leased Assets
(b) Income Statement		
- Expense	Interest and Depreciation	Total Rental

TYPES OF LEASES

C. TYPES OF LEASES

1. Direct Leases
2. Sales-Lease-Back
3. Lease-Sub-Lease
4. Personal Leases
5. Real Estate Lease
6. Discounting of Lease Receivables

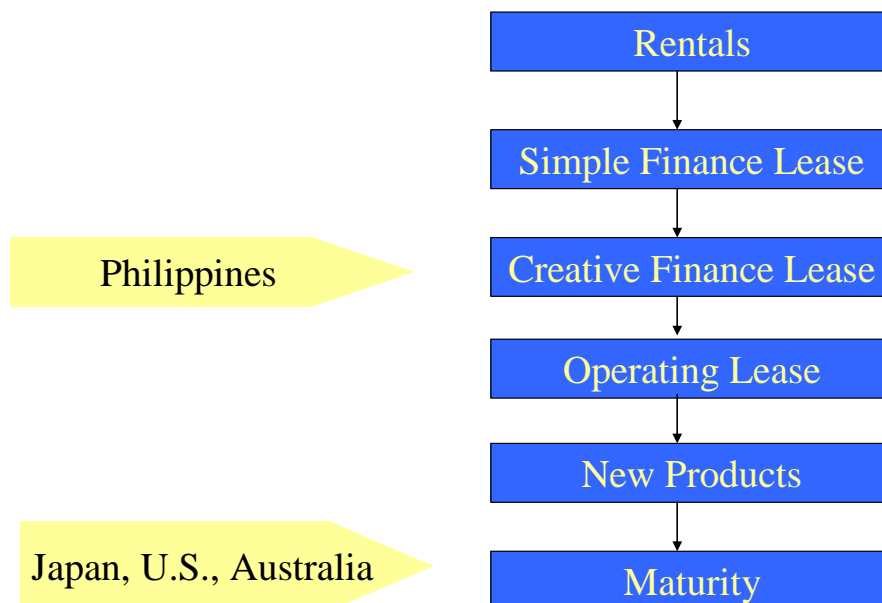
STAGES OF DEVELOPMENT OF LEASING IN THE PHILIPPINES

D. DEVELOPMENT OF LEASE IN THE PHILIPPINES

1. Leasing was introduced in the Philippines in 1956
2. Financing Company Act enacted in 1969
 - Leasing
 - Direct Loans
 - Receivables Discounting
3. Finance Lease became popular in the '80s

D. DEVELOPMENT OF LEASE IN THE PHILIPPINES

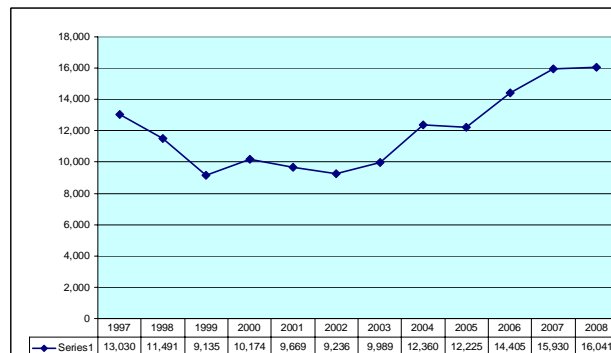
The six Phases of Leasing Cycle



D. DEVELOPMENT OF LEASE IN THE PHILIPPINES

4. Leasing volumes

- Pre-Asian Crisis level of Php13.03Bn.
- As of 2008, volume at Php16.01Bn.



Leasing Companies	2006	Market Share	2007	Market Share
1. BPI Leasing	5,107	35.5%	5,828	36.6%
2. BDO Leasing	4,825	33.5%	5,052	31.7%
3. Orix Metro Leasing	2,181	15.1%	2,684	16.8%
4. Japan PNB Leasing	969	6.7%	1,089	6.8%
5. UCPB Leasing	722	5.0%	634	4.0%
6. I BP Leasing	526	3.6%	344	2.2%
7. First Malayan Leasing	75	0.5%	187	1.2%
8. Allied Leasing	-	-	112	1.0%
	14,405	100.00%	15,930	100.0%

- The top 8 accounts for about 95% of the total industry lease volume.

D. DEVELOPMENT OF LEASE IN THE PHILIPPINES

5. Challenges to Leasing in the Philippines:

- Local market's awareness and appreciation of the benefits of Leasing;
- Taxation – use of VAT on operating lease and GRT on finance lease;
- Accounting treatment of leases; implementation of IAS17 (revised);
- Funding constraints.

REGULAR INTERACTIONS WITH GOVERNMENT REGULATORY AGENCIES

E. INTERACTIONS WITH GOVT. REGULATORS

1. Securities and Exchange Commission
2. Bangko Sentral ng Pilipinas (BSP)
3. Bureau of Internal Revenue



ASIAN LEASING & FINANCE ASSOCIATION

ADB



F. ASIAN LEASING & FINANCE ASSOCIATION

- Established in 1982, ALFA is structured as a federation of leasing companies and association operating in the Asian region.
- ALFA was created primarily to promote closer relations, co-operation and mutual understanding among lessors in Asia.
- ALFA The organization, which has its office in Indonesia, currently has 21 member countries.



ADB



F. ASIAN LEASING & FINANCE ASSOCIATION

Members:

Bangladesh
Indonesia
India
Islamic Republic of Iran
Japan
Korea
Kuwait
Republic of Kazakhstan
Kingdom of Saudi Arabia
Republic of Maldives
Philippines

Pakistan
Sri Lanka
Sultanate of Oman
Thailand
Taiwan
United Arab Emirates

Associate Members:

Singapore
USA

International Members:

Australia
Egypt

F. ASIAN LEASING & FINANCE ASSOCIATION

- ALFA provides the framework for regional cooperation in the study and research on the subject of leasing, especially on the matter of laws and regulations with the goal of encouraging the exchange and dissemination of information about leasing practices, legislation and regulation for the benefit of its members.
- ALFA also regularly conducts seminars for the benefit of its members.
- ALFA holds an annual General Assembly meeting where all member-country representatives gather to discuss developments of leasing and finance in their respective countries as well as allow members from one country to share best practices that others might be able to adopt in their own respective countries. .

THANK YOU!



**DEVELOPMENT OF THE LEASING INDUSTRY IN VIETNAM -
LESSONS LEARNED FROM OTHER JURISDICTIONS**

Hanoi, 17 March 2009

**Tax Treatment of the
Leasing Industry in SE Asia**

Presentation by Sanjay Gupta, GE



**Leasing:
Comparisons & Benefits**



Lease versus Bank Loan

Descriptions	Financial Lease	Operating Lease	Bank Credit/Loan
Minimum Period of Contract	Minimum 3 years**	No limits	No Limits
Tax advantages for Client	Lease rental is tax deductible**	Lease rental is tax deductible**	Interest + Depreciation
Depreciation tax book	Leasing company	Leasing Company	Client
Ownership of fixed assets during contract period	Leasing Company	Leasing Company	Client
VAT on monthly payment	7%** of Lease rental paid by Client	7%** of Lease rental paid by Client	No VAT on Interest



** Based on Thailand Leasing regulations

3 /
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Lease versus Bank Loan

Descriptions	Financial Lease	Operating Lease	Bank Credit/Loan
End of Period	Purchase option at minimum amount	3 Options: -Release based on Fair Mkt Value -Buy equipment @ FMV -Return the equipment	Client
Collateral	Leased assets	Leased assets	Usually Land & Building -Machinery
Accounting treatment for Client	On Book** Client will report the Depreciation and Interest Expense. (Rental payment not recorded in P&L)	Off Book** Lease Rental goes to P&L Statement	On Book** Client will report the Depreciation and Interest Expense.
Advantage	Better for tax planning	Cash – flow planning	Working Capital and Project Financing
VAT on Equipment	Paid by Leasing Company **	Paid by Leasing Company **	Paid by Client**



** Based on Thailand Leasing regulations

4 /
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Financial Lease

Other Benefits

Tax planning

- Higher tax saving vs Bank Loan or self-financing : higher expense in Tax book (if Lease rental is tax deductible)

Alternative source of financing

- For both new and existing machines

Flexible financing structure

- Step down payment – flexibility to suit business plan and cash flow.

Specific to Sale and Lease Back

- Utilization of Tax Losses
- Obtain Capital Gain when Market Value higher than Book Value

Operating Lease

Benefits and Test

No Asset Risk

- Cost benefit and return option is more important than ownership

No Risk of Obsolescence

Off Balance Sheet treatment

An Operating Lease Should Follow: (FASB 13 Test)

- No Bargain Purchase Option
- No Automatic Transfer Of Ownership to Lessee
- Term Must not Exceed 75 % of the Equipment Life of the Property.
- Present Value (PV) of Lease Rental received by Lessor < 90 % of the Assets Cost

Leasing offers many benefits

imagination at work

5 / GE / 16 September, 2009

Key Factors In Leasing Industry

imagination at work

6 / GE / 16 September, 2009

Tax & Accounting Developments in Asia



Tax Treatment For Leasing



Sources: BNM, APPI, World Leasing News, SCRIBD, Japan Leasing Association



ABRIDGED

Lease rental tax deductible



Indonesia

Emerged in	1973
Total Leasing Company	100 +
Product	Financial & Operating Lease
Growth	25%
Volume as of 2007	US\$ 6 Billion



India

Emerged in	1973
Total Leasing Company	250 +
Product	Financial & Operating Lease
Growth	30%
Volume as of 2007	US\$ 7-8 Billion



Thailand

Emerged in	1970
Total Leasing Company	50 +
Product	Financial & Operating Lease
Growth	20%
Volume as of 2007	US\$ 3 Billion



Malaysia

Emerged in	1970
Total Leasing Company	N/A
Product	Financial & Operating Lease
Growth	15 - 20%
Volume as of 2007	US\$ 2 Billion

Lease treated as Loan



China

Emerged in	1981
Total Leasing Company	68 under LBC & FLP*
Product	Financial & Operating Lease
Growth	30%
Volume as of 2007	US\$ 5 Billion



Vietnam

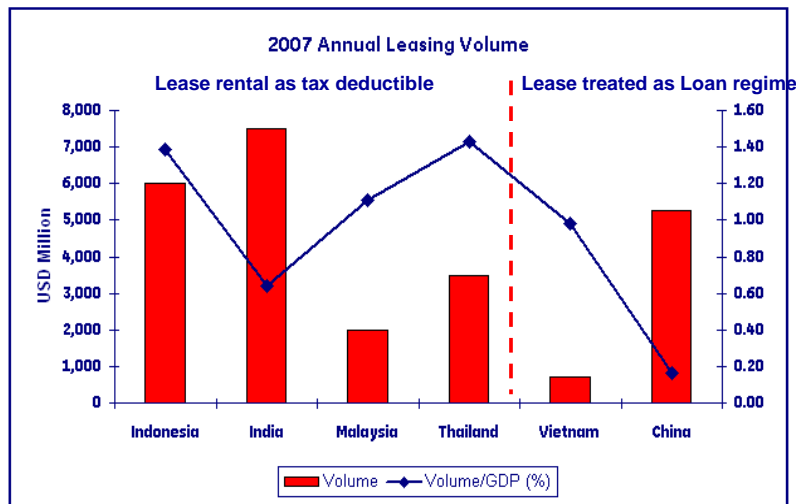
Emerged in	1995
Total Leasing Company	11 as of 2007
Product	Financial & Operational Lease
Growth	30%
Volume as of 2007	US\$ 400 MM



Sources: World Leasing News, ELFA, Leasing Notes, APPI, White Clark Global Leasing

9 /
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Industry Size & Penetration







Sources: World Leasing News, ELFA, Leasing Notes, APPI

- **China** : Continuous growth – Leasing Law in Process
- **India** : growth influenced by income tax legislation & Sources of Funding
- **Malaysia, Thailand, Indonesia** : build up phases
- **Vietnam** : big potential



10 /
GE /
16 September, 2009

Macro Change Impact on Industry : examples

COUNTRY	CHANGES	IMPLICATION	RESULT	LEASING INDUSTRY IMPACT
PHILIPPINES	In 1997, Financial Lease to be recorded in Accounting Book. ACCOUNTING POLICY CHANGES	On Book Funding	Lease Obligation is recorded	
INDIA	In 2001 IAS 19 introduced for Financial Lease Transaction . ACCOUNTING POLICY CHANGES Sales tax on lease transaction TAX POLICY CHANGES	On book Funding Tax advantage of leasing declines	Lease Obligation is recorded Leasing became less competitive	
INDONESIA	New regulation for Joint Financing and Channeling FUNDING RESOURCES	Leasing company agent of bank for Leasing transaction	New funding method for Lessor	
THAILAND	Banks allowed Leasing transactions. Banks set up own Leasing companies for ease OPERATIONAL EXPANSION	Funding resources	Leasing company grows outside banking sector	



Sources: World Leasing News, ELFA, Leasing Notes, APPI

11 / GE / 16 September, 2009

Lease Product & Services : examples

THAILAND & INDONESIA

- Sales and Lease back of existing equipment to utilize tax Losses and working capital.
- Fleet financing for truck and company car (Financial & Operating Lease).
- Vendor Financing Program: OEM & distribution to support product sales (eg: Hyster & Yale Forklift Program, Komatsu/Caterpillar Construction Equipment Program)
- Operating Lease transaction for IT/Computer equipment: minimize risk obsolescence & change of technology (eg DELL, IBM, Sun Microsystems, NCR)
- Operating Lease transaction for Mining Industry: Giant Excavators & Bulldozers, Mining Trucks/Dumpers
- Bank partnership (Channeling and Joint Financing): Alternative funding: customer still getting leasing benefit
- Corporate Aircraft Financing



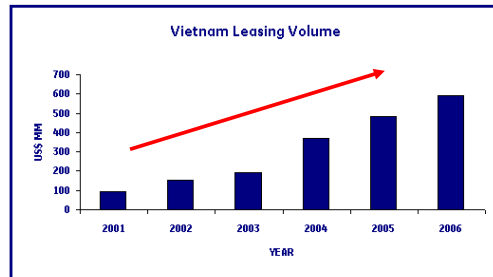
12 / GE / 16 September, 2009

Vietnam's Leasing Industry



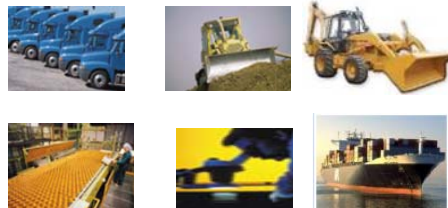
Vietnam Leasing Industry

- ✓ 11 Leasing Company In The Market (2007).
- ✓ Registration Of Leased Asset
- ✓ Funding Can Be In Local And Foreign Currency
- ✓ Financial And Operating Lease Product
- ✓ Leasing Association Is In Place
- ✓ Volumes have grown ~ 35% pm
- ✓ Open to 100% foreign investors

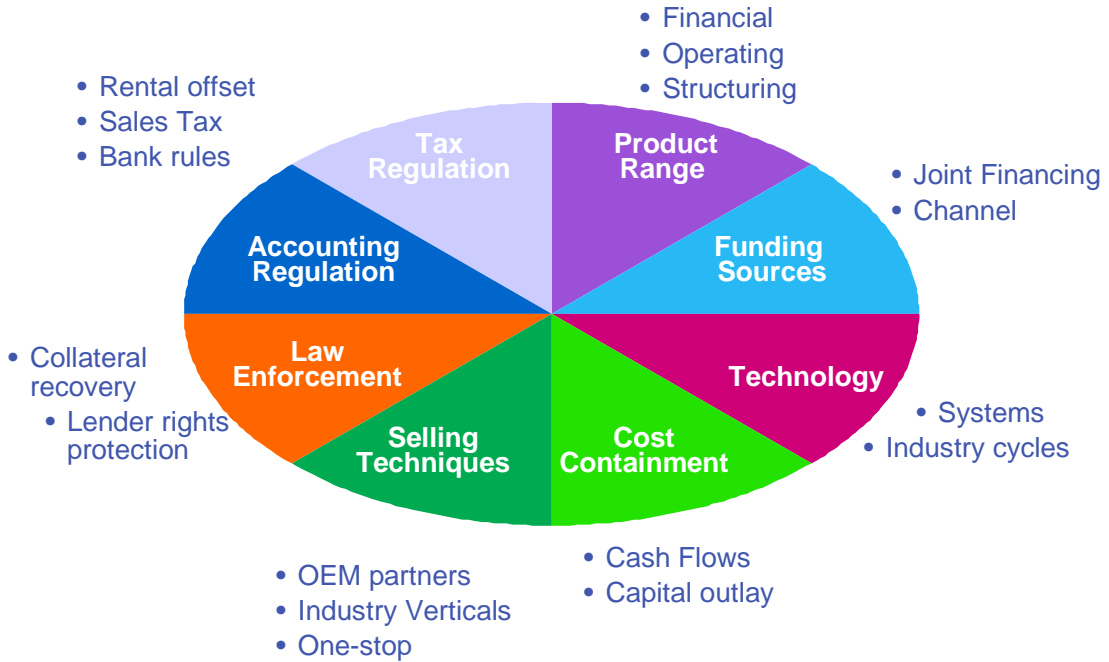


Growing business ~ 35% CAGR

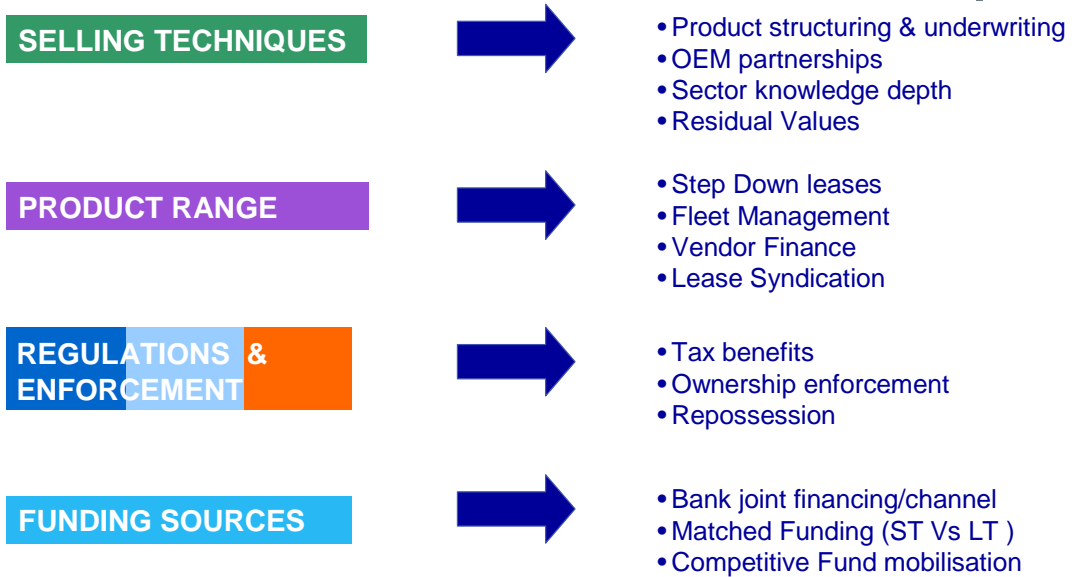
- ✓ Broad Coverage:
 - Mining and Construction
 - Healthcare
 - Transportation
 - Manufacturing



Key Factors In Leasing Industry



Vietnam Leasing Industry: Possible areas to develop further



Conclusion & Case Study



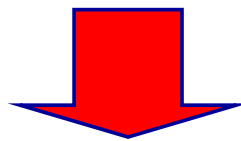
Balance Sheet Efficiency & Leasing

$$R/E = R/S \times S/A \times A/E$$

Return on Equity = *Return on Sales* x *Asset Efficiency* x *Leverage*

Management Focus

- Cost Control
- Increase Prices
- Productivity
- Quality Process



Opportunity

- Reduce Inventories
 - "Just In Time"
- Reduce Receivables
 - Tight payment control
 - Receivable financing
- Asset Securitization
- Outsourcing
- **Operating Leases**

Target Range

- Banking Limits
- Stock Market Risk
- Management Prudence
- Industry Risk



CASE STUDY



Lease Solution – Lease Rental Is Tax Deductible

DEAL STRUCTURE:

- Proposal: To finance expansion value THB 530 MM through Sale & Lease Back
- Lease term 4 years

	1 4-year Lease Equal Repayment
Equipment	Production Line
Existing Equipment Book Value (THB)	530,000,000
Total Transaction (THB)	530,000,000
Depreciation (years)	Straight Line Average 10 years
Tax Rate	30%
WACC	9%
Advance Rental (%)	0%
Advance Rental (THB)	0
Funding Amount (THB)	530,000,000
Lease Tenor (years)	4 years
Repayment Structure	Monthly equal
Lease Rate on Gross Amount	7.50%
Structuring Fee (%)	0.00%
Results	
Comparable Loan Rate	1.51%
Benefit in PV Term (THB)	40,938,027

Lower after-tax cost compared to bank loan



ABRIDGED

Accounting – Lessee

FINANCIAL LEASE

Pre - Lease

ASSETS		LIABILITIES	
A/R	100	Liabilities	500
Machine	530	Equity	500
Other Assets	370		



Post – Lease – Sale & Lease Back

ASSETS		LIABILITIES	
Cash	530	Liabilities	500
A/R	100	Equity	500
Assets under Lease	530	Fin. Lease	530
Other Assets	370		

Accounting Similar To Loan

BALANCE SHEET

OPERATING LEASE

Pre - Lease

ASSETS		LIABILITIES	
A/R	100	Liabilities	500
Machine	530	Equity	500
Other Assets	370		



Post – Lease – Sale & Lease Back

ASSETS		LIABILITIES	
Cash	530	Liabilities	500
A/R	100	Equity	500
Other Assets	370		

Off Balance Sheet Funding



Financial Lease Cash Flows

Year	Principal Pmt	Interest	Rental Payment	Principal Balance	Cash flow	Depreciation
0				530	-530	0
1	132.5	35.195	167.695	397.5		53
2	132.5	26.287	157.787	265		53
3	132.5	16.32	147.82	132.5		53
4	132.5	5.913	137.813	0		53
5						53
6						53
7						53
8						53
9						53
10						53
Total						530

MANAGEMENT BOOK PRE LEASE

No	Description	Pre lease
1	Revenue	1,000,000.000
2	COGS	700,000.000
3	Gross Profit	300,000.000
4	Interest Expenses	35,195.000
5	Depreciation	53,000.000
6	Total Dep + Interest	88,195.000
7	Profit before tax	211,805.000
8	Tax (30%)	63,541.500
9	Profit after tax	148,263.500

Y1 Tax Calculation Post Lease

No	Description	Post - Lease
1	Revenue	1,000,000.000
2	COGS	700,000.000
3	Gross Profit	300,000.000
4	Lease rental	167,695.000
5	Depreciation	0
6	Profit Before tax	132,305.000
7	Tax (30%)	39,691.500

MANAGEMENT BOOK POST LEASE

No	Description	Post - Lease
1	Revenue	1,000,000.000
2	COGS	700,000.000
3	Gross Profit	300,000.000
4	Interest Expenses	35,195.000
5	Depreciation	53,000.000
6	Total Dep + Interest	88,195.000
7	Profit before tax	211,805.000
8	Tax	39,691.500
9	Profit after tax	172,113.500

Leasing : No Change on PBT, benefits PAT



Lease Rental Is Tax Deductible

- DEAL STRUCTURE:
- Proposal: Buying New Machine under financial lease
- Lease term : 4 years

DESCRIPTIONS	4-year Lease Equal Repayment
Equipment New Machine (THB)	New Product Line 200,000,000
Total Transaction (THB)	200,000,000
Depreciation (years)	Straight Line Average 10 years
Tax Rate	30%
WACC	9%
Advance Rental (%)	0%
Advance Rental (THB)	0
Funding Amount (THB)	200,000,000
Lease Tenor (years)	4 years
Repayment Structure	Monthly equal
Lease Rate on Gross Amount	7.00%
Structuring Fee (%)	0.00%
Results	
Comparable Loan Rate	1.51%
Benefit in PV Term (THB)	14,158,145



23 /
GE /
16 September, 2009

Lease Accounting – Lessee

FINANCIAL LEASE

BALANCE SHEET

OPERATING LEASE

Pre - Lease

ASSETS		LIABILITIES	
A/R	100	Liabilities	100
Fixed Assets	400	Equity	400



Post – Lease – Financing New Machine

ASSETS		LIABILITIES	
A/R	100	Liabilities	100
Other Asset	400	Fin. Lease	200
Assets under Lease	200	Equity	400

Accounting Similiar To Loan

Pre - Lease

ASSETS		LIABILITIES	
A/R	100	Liabilities	100
Fixed Asset	400	Equity	400



Post – Lease – Financing New Machine

ASSETS		LIABILITIES	
A/R	100	Liabilities	100
Fixed Asset	400	Equity	400

Off Balance Sheet Funding



24 /
GE /
16 September, 2009

Financial Lease Cash Flows

Principal (MM)	200					
Tenor (yrs)	4					
Rate	7%					
Depreciation	10					
Year	Principal	Interest	Rental Payment	Principal Balance	Cashflow	Depreciation
0				200	-200	0
1	50	12.3	62.3	150		20
2	50	8.8	58.8	100		20
3	50	5.4	55.4	50		20
4	50	1.8	51.8	0		20
5						20
6						20
7						20
8						20
9						20
10						20

Y1 Tax Calculation Post Lease

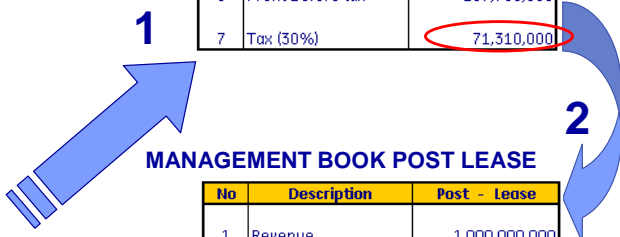
No	Description	Post - Lease
1	Revenue	1,000,000,000
2	COGS	700,000,000
3	Gross Profit	300,000,000
4	Lease rental	62,300,000
5	Depreciation	0
6	Profit Before tax	237,700,000
7	Tax (30%)	71,310,000

MANAGEMENT BOOK PRE LEASE

No	Description	Pre lease
1	Revenue	1,000,000,000
2	COGS	700,000,000
3	Gross Profit	300,000,000
4	Interest Expenses	12,300,000
5	Depreciation	20,000,000
6	Total Dep + Interest	32,300,000
7	Profit before tax	267,700,000
8	Tax (30%)	80,310,000
9	Profit after tax	187,390,000

MANAGEMENT BOOK POST LEASE

No	Description	Post - Lease
1	Revenue	1,000,000,000
2	COGS	700,000,000
3	Gross Profit	300,000,000
4	Interest Expenses	12,300,000
5	Depreciation	20,000,000
6	Total Dep + Interest	32,300,000
7	Profit before tax	267,700,000
8	Tax	71,310,000
9	Profit after tax	196,390,000



Thank You



imagination at work