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Indochina notes

Legal updates on investment, infrastructure and finance

Contents

New appointment

Investment

Infrastructure

Banking and finance

New appointment

Our Vietnam practice has expanded again with the arrival of Mara Folz. Mara gained her JD from New York University School of Law in May 2000 and is admitted to the New York Bar. She has four years of corporate privatisation, restructuring and capital markets experience. She was recruited by Shearman & Sterling for the corporate finance team in Singapore in September 2000 and worked on a broad range of matters, including various capital market transactions, acting for both issuer and underwriters. She gained a broad range of experience in securities offerings and listings. She has also spent two years at Hunton & Williams based in Manila representing the government of the Philippines in the privatisation of its electricity industry and the restructuring of US\$5.5bn debt of the National Power Corporation.

Investment

Competition law

A new law on competition was passed by the National Assembly on 9 November 2004. A report on the implications of this law will be contained in one of our regular sector updates to be issued soon.

Supermarkets and trade centres

Supermarkets and other retail outlets are multiplying to keep pace with the increasing purchasing power of the local populace. There are even now a limited number of foreign supermarkets. The result has inevitably been more regulation. The Ministry of Trade weighed in on 24 September 2004 with Decision 1371 on supermarkets and trade centres.

- Trade centres can provide services, such as office accommodation, restaurants and entertainment, as well as goods; supermarkets simply supply goods.
- Supermarkets must have a total commercial floor area of at least 500m² and must sell at least 4,000 different kinds of goods. Trade centres must have a total commercial floor area of at least 10,000m², have a parking area, and operate various commercial services.
- If the outlet has a foreign name, the Vietnamese name must appear first; only then, in smaller text, may the foreign name appear, limiting international branding somewhat.
- Outlets must comply with relevant development plans. The only snag is that in many cases the development plan may not be readily available.

Conversion of foreign-invested enterprises (FIEs)

The government is to report to the National Assembly by May 2005 on the implementation of Decree 38 on the conversion of FIEs into shareholding companies. Over a year has passed since the government launched the pilot conversion project, but progress has not been as visible as the optimists had hoped.

A step towards giving the government something positive to report was made on 16 September 2004, when, in Official Correspondence 1325, the Prime Minister gave approval in principle for six FIEs – Taya (Vietnam) Electric Cable & Wire, Austnam, Interfoods, Taicera Ceramic Industry, Tungkuang Industrial, and Royal International – to convert. The six companies have been given until the end of the year to submit their applications.

Personal income tax

In Official Letter 2759 dated 30 August 2004, the General Department of Taxation confirmed that income derived from a company's employee stock option plan is to be calculated as regular income, and is subject to personal income tax.

State-owned enterprises (SOEs)

Equitisation of SOEs has been underway for as long as we have had offices in Vietnam (over ten years). Recent figures demonstrate that about 5 per cent of the SOEs (in terms of value) have been equitised. Such limited success breeds constant tinkering with the process to try to find a formula that works. Decision 155 dated 24 August 2004 is the latest effort. Decision 155 classifies SOEs into: (i) those in which the state will retain ownership – which may be full ownership or majority/minority ownership (requiring equitisation); and (ii) those to be merged, consolidated or dissolved.

- The state will continue to retain full ownership over SOEs engaged in important sectors, including national power transmission, national and international telecoms backbone networks, production of cigarettes, management and maintenance of national railways, and airports and seaports that are large and in important locations as decided by the Prime Minister and 'other important sectors as decided by the Prime Minister'.
- The state will continue to own 100 per cent of SOEs operating in the 'less important' sectors of petroleum processing; distribution of pharmaceuticals, food, petrol and oil; and air and rail transportation if these companies have at least VND30bn of state capital and have contributed an average of VND3bn to the state budget annually for the past three years.
- Certain SOEs will be equitised but the state will retain a controlling interest. These are SOEs (i) holding state capital of at least VND20bn, (ii) contributing an average of VND2bn to the state budget each year for the past three years, and (iii) operating in one of the following sectors: petroleum processing; distribution of pharmaceuticals, food, petrol or oil; air and rail transportation; power generation; mining; provision of telecoms infrastructure; steel manufacturing; cement manufacturing; production of milk and beer (capacity of over 50m tons per year) and alcohol (capacity of over 10m tons per year); water sanitation

and supply; and banking and insurance. Under former Decision 58, SOEs of this type remained under 100 per cent state ownership.

- SOEs not included above are to be equitised with the state retaining up to 50 per cent of the shares. The level of state ownership will be decided by 'competent state bodies' on a case-by-case basis.
- Companies that have 'suffered losses' for more than two or three years may, depending on the facts, be merged into other SOEs, dissolved or put into bankruptcy.

Auto industry

Visitors to Vietnam's cities are often impressed by the colourful chaos on the streets. Sadly, chaos may soon be replaced by gridlock. The master plan for the development of the Vietnamese automobile industry contained in Decision 177 dated 5 October 2004 contains even more than the usual dose of exhortatory rhetoric.

- The production target is around 240,000 automobiles by 2010.
- In order to raise the US\$1.1bn of capital required for the period to 2010, some state-owned manufacturers and assemblers are to be equitised. Some of these shares may even be sold to foreign investors, though it is hard to see too many investors rushing into this sector.
- Support for the industry is to be provided by means of preferential tax treatment (which will surprise those manufacturers suffering from current tax policies), investment, science and technology, human resources, capital mobilisation and sector management.
- FIEs are encouraged to invest in the manufacture of spare parts and engines using advanced technology. FIEs will not be surprised to know that they are entitled to all investment incentives provided under the FIL.
- SOEs will have specific functions: (i) the Vietnam Auto Industry Corporation will focus on the manufacture and assembly of cars, buses and trucks, and the manufacture of engines and gearboxes; (ii) the Agricultural Machine and Engine Corporation will assemble buses, and small and medium sized trucks for agricultural purposes; (iii) the Viet Nam Coal Corporation will produce heavy-duty and special purpose trucks; and (iv) Saigon

Transportation Machinery Corporation will produce and assemble buses, special purpose vehicles and certain spare parts.

Infrastructure

Electricity law

A new Law on Electricity was passed by the National Assembly on 10 November 2004. A report on the implications of this law will be contained in one of our regular sector updates to be issued soon.

Electricity development strategy

The Prime Minister recently approved the Strategy for Electricity Development in 2004-2010 with a view towards 2020 in Decision 176 dated 5 October 2004.

Principles

The goal is gradually to develop a competitive power market by encouraging various economic sectors to participate in the industry, not just the state. The state will retain its monopoly in transmission, and in large-scale hydro and nuclear power plants.

Objectives

- The objectives are to (i) balance hydropower with gas and coal fired power; (ii) build up gas power/fertiliser facilities in Phu My and in the south-west of Vietnam; (iii) accelerate the construction of the Son La hydropower plant; (iv) research the use of nuclear power; (v) modernise the power distribution grid; (vi) diversify the forms of investment in the industry; (vii) issue appropriate policies on the use of power in rural and mountainous areas; and (viii) make electricity prices more competitive with those of other countries in the region.
- The government aims for output of 53bn kWh by 2005, 83-93bn kWh by 2010, and 201-250bn kWh by 2020.

Strategies

- Electricity of Vietnam (EVN) will invest only in generation projects with a capacity of 100 MW or more, opening the door for non-state enterprises to invest in smaller projects.

- Priority will be given to hydropower projects, particularly those with additional benefits, such as flood and drought prevention.
- EVN will remain the only entity to be provided with Official Development Aid (ODA) in the electricity sector.
- Capital for the development of the electricity industry will be obtained from ODA and long-term loans from banks and international finance corporations (although loans from foreign commercial banks will be sought only if domestic banks are unable to provide them), the securities markets and issuance of bonds (both local and overseas). Foreign investment projects are apparently encouraged.
- A power pool will be set up within EVN. Electricity companies within EVN will participate in the pool, with each subsidiary able to set its own tariff. In the longer term, the government is considering establishing a legal framework for a broader power pool.

Telecoms

Until recently, no regulations implementing the 2002 Ordinance on Post and Telecommunications had been issued. Consequently, the old regulations, such as Decree 109 dated 12 November 1997 and Circular 4 dated 29 September 1998, continued to be applied.

Better late than never, on 3 September 2004 the government issued Decree 160. This governs numerous matters, such as (i) network establishment, (ii) provision and use of services, (iii) production, import and export of equipment, and (iv) construction and installation.

Cross border telecoms service

Decree 160 effectively prevents foreign telecoms companies from providing telecoms services directly to end users in Vietnam. Foreign service providers must enter into agreements with Vietnamese enterprises through international gateways. End users in Vietnam can obtain telecoms services only through domestic Vietnamese telecoms providers.

Restrictions on monopoly positions

The ordinance imposed restrictions on telecoms providers that had a dominant market share. Decree 160

defines the term 'dominant market share' to mean providers that (i) receive more than 30 per cent of their total revenue or telecoms traffic in the licensed geographic area and (ii) are able to influence the entry of other telecoms enterprises into the market.

Decree 160 also imposes restrictions on telecoms providers that have more than (i) 30 per cent of the capacity of the local loop in the licensed geographic area, (ii) 30 per cent of the capacity of the domestic or international long-distance transmission channels, or (iii) 30 per cent of the base radio stations of the terrestrial mobile network. The restrictions include having to obtain approval from the Ministry of Posts and Telematics (MPT) and to make public a model connection agreement.

Post and Telecommunications Conglomerate

The MPT presented its proposal on the establishment of a Post and Telecommunications Conglomerate on 17 August 2004. Under Notice 171 dated 1 September 2004, the conglomerate should:

- do business both domestically and abroad – its main activities will be post, telecoms and information technology;
- have the power to invest in other enterprises;
- manage the telecoms backbone network (which will be accounted for separately) and undertake other tasks in the public interest;
- include Vietnam Posts and Telecommunications Corporation (VNPT); and
- base its charter on the Enterprise Law and Decree 153.

VNPT will submit a list of telecoms enterprises for equitisation to the Prime Minister, including two mobile telephone companies. It will also select certain affiliates for listing on the Vietnam Stock Exchange. This should provide a big boost for the fledgling market.

Banking and finance

Factoring

The old art of factoring has finally arrived. The State Bank of Vietnam (SBV) issued Decision 1069 on 6 September 2004 to authorise factoring in Vietnam.

A credit institution wishing to carry out payment factoring must (i) have approval from the SBV, (ii) have overdue debts of less than 5 per cent of its total loan

balance, (iii) not be in violation of any regulations on banking safety, and (iv) not be under any investigation. In addition, the credit institution must have a permit to deal in foreign exchange if import-export transactions are involved.

There are a number of restrictions and exclusions. Notably, payment factoring may not be carried out for receivables arising from a sale and purchase transaction whose payment period exceeds 180 days.

A credit institution is not permitted to provide payment factoring to a customer in an amount exceeding 15 per cent of its capital, and total factoring amounts for all customers must not exceed its total capital.

Discounting of valuable paper

A Vietnamese legal basis for repo transactions has also arrived. The SBV issued Decision 1325 on 15 October 2004 on the discount and rediscount of valuable papers by credit institutions. Decision 1325 contemplates (i) transactions for the discount of valuable papers (including SBV Bills, Treasury Bills, Treasury Bonds, Central Government Project Bonds, Local Government Bonds, Investment Bonds, National Construction Bonds and Bonds guaranteed by the government) between credit institutions and customers and (ii) transactions for the rediscount of valuable papers between credit institutions. Decision 1325 also covers repurchase and buy/sell back transactions.

Decision 1325 requires the discount and rediscount of valuable papers to be made in a written contract whose contents are consistent with the model contract issued by the Vietnam Bankers Association. The model contract referred to in Decision 1325 was issued in conjunction with Decision 284 of the Vietnam Bankers Association dated 13 September 2004. The model contract is a simplified version of the TBMA/ISMA Global Master Repurchase Agreement (version 2000) issued by the International Securities Market Association.

Cheques

Cheques are not widely used in Vietnam, in part because of the risk of non-payment. With the intention of reducing such risk, the SBV issued Circular 5 dated 15 September 2004 implementing Decree 159 of the Government dated 10 December 2003 on cheques.

Circular 5 sets out the measures to be applied against a person who issues a cheque that is not honoured. The penalties range from a warning to forfeiture of the right to issue cheques. Circular 5 also requires credit institutions (i) to submit information on customers who have violated cheque regulations to the Credit Information Centre of the SBV, and (ii) to search information held at the Credit Information Centre before issuing cheque books to customers.

Securities investment funds and fund management companies

Vietnam is at the dawn of the domestic investment fund age. One domestic investment fund, Vietfund, has been established. Others are waiting in the wings. The law is just about keeping pace with the facts, with the Ministry of Finance (MOF) issuing Decision 73 on securities investment funds and fund management companies. This specifically enables investment funds to list their certificates on the stock market.

A public fund is prohibited from (i) investing in its own certificates or certificates of other funds, (ii) investing in more than 15 per cent of the securities of an issuer, (iii) investing more than 20 per cent of its assets in one issuer, (iv) investing more than 10 per cent of its assets in immovable property, (v) investing more than 30 per cent of its assets in its affiliates, and (vi) using its own capital or assets to secure borrowings to finance its operations.

Member funds are not subject to the restrictions applicable to public funds. However, a member fund is required to invest at least 60 per cent of the value of its assets in securities.

A fund management company, which can be either a 100 per cent domestic company or a joint venture company, can establish and manage both public and member funds. It is prohibited, among other things, from (i) being a related person of the custodian bank, (ii) investing in funds it manages, (iii) investing in another fund management company or a securities company, (iv) using its capital to purchase assets of another fund it manages, and (v) using the capital and assets of funds under its management to invest in more than 49 per cent of an issuer or an unlisted company.

State Securities Committee (SSC)

Decision 161 sets out regulations on the organisation and powers of the SSC. This is the first time these matters have been documented since the transfer of the SSC to the MOF. Under this Decision, the SSC is responsible to the MOF for the management of the securities market. In particular, it is responsible for:

- adopting legislation on securities and securities markets;
- formulating proposals on the establishment and operation of securities trading centres, stock exchanges, securities custody centres etc, and managing their operations once established;
- issuing approvals/permits relating to all forms of securities business; and
- supervising entities operating in the securities market and handling violations of securities regulations.

Administrative sanctions for violation of securities regulations

The lure of quick money through securities shortcuts exists in many countries and Vietnam is no exception. The government issued Decree 161 on 7 September 2004 to update the administrative sanctions for violations of securities laws. Larger fines can be imposed under Decree 161 than under previous legislation: fines of up to VND70m (compared to the previous VND50m) may be imposed for violations relating to the issuance, listing, trading, or registration of securities, and a fine of up to VND50m (compared to the previous VND20m) may be imposed for violations relating to disclosure of information. It is still questionable whether these fines are large enough, but other sanctions such as confiscation of income/securities, compulsory rectification of false information, withdrawal of securities, and compulsory return of deposits or purchase monies are also possible.

Taxes applicable to securities business

Circular 100 of the MOF dated 20 October 2004 contains the following provisions.

- Certain businesses will not be subject to VAT: securities brokerage; securities self-trading; investment management; guarantee and agency for issuing securities; consultancy on securities finance and investment; investment fund management and

supervision; securities custody; representation of bonds' owners; and investment activities by a securities investment fund.

- Securities companies and fund management companies will pay 20 per cent CIT for the first ten years of operation. Any such companies already in operation and paying CIT at higher rates will have their CIT rates reduced to 20 per cent for the remaining period of their first 10 years of operation. Newly established securities and fund management companies will be exempt from CIT for two years from the time they become profitable and have a 50 per cent reduction for the three following years.

Insurance

Establishment and operation of insurers and insurance brokers

The MOF issued Circular 98 on 19 October 2004 guiding the implementation of Decree 42 on insurance business. This Circular replaces Circular 71 on the same subject. Circular 98 has made certain changes.

- It expands the requirements for obtaining MOF approval of life, health, and personal accident insurance products. Papers to be submitted to the MOF for this approval include (i) the bases for calculating premia for the proposed products (for life products that distribute dividends, the percentage dividend distribution the insurer promises to clients must not be less than 70 per cent of the total revenue from the insurance contract, using the method agreed by the MOF); and (ii) the insurer's explanatory material on its products and services, sales literature and sample forms of information that a client must disclose and sign when purchasing insurance.
- To raise the quality of financial management of insurers, Circular 98 for the first time provides for the appointment of an actuary for life insurance business who must (i) have experience as an actuary in the life insurance sector, and (ii) be approved by the MOF.
- Reinsurance can be arranged only with offshore reinsurance companies that are ranked at least BBB by Standards & Poors, B++ by AM Best or Baa by Moody's. Insurers should only retain a maximum liability for each risk of up to 10 per cent of owner's equity.

Financial regime applicable to insurers and insurance brokers

Circular 99 of the MOF on 19 October 2004 contains certain advances on the former Circular 72:

- the provisions on establishment of insurance reserves by non-life insurers and by life insurers have been re-written;
- life insurers must keep accounts for policy owners' funds and shareholders' funds separate from accounts for premia received; and
- insurers and insurance brokers are now required to publicise their audited financial reports.

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