

Vietnam tightens conditions for offshore loans

In brief

The State Bank of Vietnam (SBV) released a draft circular on conditions for enterprises' offshore loans without government guarantee ("**Draft Circular**"), which aims to replace Circular No. 12/2014/TT-NHNN dated 31 March 2014 ("**Circular 12**"). The Draft Circular tightens the control on offshore loans to tackle the risk of excess national foreign debt quota and to promote the onshore loan market. Borrowers are now expected to meet additional conditions to borrow offshore loans without government guarantee.

Notable points of the general and specific conditions applicable to borrowers under the Draft Circular are as follows:

1. General conditions:
 - a. Appointing an onshore enforcement agent with regards to Vietnamese-located collaterals;
 - b. Imposing a ceiling on borrowing costs applicable to offshore loans; and
 - c. Using foreign currency derivatives to hedge exchange rate risk.
2. Particular conditions:
 - a. Changes to loan purposes;
 - b. Imposing a borrowing limit applicable to an enterprise; and
 - c. Imposing a borrowing limit applicable to credit institutions and foreign bank branches.

Further details regarding these are addressed below, along with other new additional points of the Draft Circular.

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In depth

1. General conditions

a. Requirement of appointment of an onshore enforcement agent with regards to Vietnamese-located collaterals

The Draft Circular requests that in case the offshore loan is secured by collaterals in Vietnam, parties to the loan agreement must engage a credit institution, foreign bank branch, or other legal entity established and operating under Vietnamese law to act as an enforcement agent.

The exception to this requirement is applied in the case where the securing party and the secured party has agreed that in the case of enforcement, the secured party shall take over the collateral in lieu of the performance of the secured liabilities.

There are some implications regarding the proposed provision as follows:

- (i) To take the enforcement agent role, the onshore enterprises should be licensed to conduct such activities. It seems that current Vietnamese law only provides for the activity of "asset management agency" under Article 106 of Law on Credit Institutions. Up to now, it seems that only credit institutions and foreign bank branches are licensed to carry out "asset



management agency" activities, and therefore can be allowed to take the role of enforcement agent. However, the Draft Circular suggests that legal entities established and operating under Vietnamese law (other than credit institutions and foreign bank branches) can also be security agents in cross-border financings. As such, further guidance on the conditions for such legal entities to take the enforcement agent role should be promulgated by the SBV.

- (ii) In practice, most financing transactions usually include the role of security agent, which is authorized by secured parties to hold the security from the execution of the security agreement. Upon the occurrence of an enforcement event, the security agent may directly handle the enforcement of secured assets or appoint one or more entities or persons to be an enforcement agent for the purposes of exercising the rights of the security agent. The draft provision raises the question as to whether the onshore enforcement agent would need to be appointed from the execution date of the security agreement or may be authorized by the security agent when the security is enforceable if the security agent is an offshore entity.
- (iii) In addition, it is unclear whether parties are required to engage an onshore entity to act as the enforcement agent in the foreign financing transactions involving collaterals located in Vietnam, particularly purely offshore bilateral loans. If this is the case, there may be hesitation by offshore lenders to lend to onshore borrowers as the security structure may be burdensome and inflexible.

b. Imposing a ceiling on borrowing costs

The current Circular 12 sets forth a principle that, if necessary, the SBV Governor may determine the ceiling on borrowing costs for each interest period. In fact, the Governor has not imposed a ceiling on the borrowing costs for offshore loans. Under the Draft Circular, the SBV proposes a specific ceiling on borrowing costs as follows:

- (i) For offshore loans denominated in foreign currency:
 - In case the reference rate is used: Reference rate + 8% per annum; or
 - In case the reference rate is not used: SOFR Term Rate¹ + 8% per annum.
- (ii) For offshore loans denominated in Vietnamese Dong: Vietnamese Government bond interest rate + 8% per annum.

The interest rate of Vietnamese Government bonds is the latest implemented interest rate of 10-year government bonds in Vietnamese Dong as determined prior to the signing date of the loan agreement and its relevant amendments/supplements.

The Draft Circular defines that offshore borrowing expenses may include interest, internal rate of return (IRR), other related fees and charges, that borrowers have to pay to lenders, guarantors, insurers, agents, and other stakeholders, and exclude late payment interest, commitment fee (if draw down is not made), prepayment fee, fee for foreign currency derivatives, fee for interest rate derivatives, foreign contractor tax. The borrowing costs are converted at an annual percentage of loan quota.

Borrowers are responsible for preparing a table of estimated offshore loan expenses in compliance with the following principles:

- (i) The offshore loan expenses are estimated at the time of signing of the loan agreement and its relevant amendments/supplements.
- (ii) The table of offshore loan expenses must be signed by the legal representative of the borrower to guarantee the accuracy.

The borrowing cost would apply for both medium/long-term offshore loans and short-term offshore loans.

For medium and long-term offshore loans, the SBV shall supervise compliance with borrowing cost ceilings via offshore loan registration procedures. For short-term loans, under the Draft Circular, the borrower is required to declare the table of estimated offshore loan expenses to the account bank when making a draw down or repayment. This means that the account bank shall be in charge of the supervision role to verify offshore borrowing costs upon draw down and repayment.

The offshore lenders, borrowers and account banks are advised to take into account the above proposal. If there is no change once officially issued, it may affect their calculation method of borrowing costs and impose more compliance obligations.

¹ SOFR Term Rate provides an indication of the forward-looking measurement of overnight SOFR, based on market expectations implied from derivatives markets. SOFR Term Rate is administered by CME Group Benchmark Administration Limited (CBA) which is registered under Benchmarks (Amendment and Transitional Provision) (EU Exit) Regulations 2019 (SI 2019/657) is authorized and supervised by the UK Financial Conduct Authority (FCA) and is aligned to the IOSCO Principles for Financial Benchmarks.



c. Foreign currency derivatives

The Draft Circular proposes that borrowers must conduct the exchange rate hedging in the following cases:

Loan tenor	Applicable value	Transaction date	Transaction value
Short-term	Loan amount of more than USD 500,000 or in other foreign currency of equivalent value	Either prior to or on the draw down date	At least 30% of draw down amount
Medium- and long-term	Each repayment instalment of principal amount of more than USD 500,000 or in other foreign currency of equivalent value	At least 3 months prior to repayment date of principal amount of such instalment	At least 30% of the principal amount to be repaid in such instalment

The requirement to conduct the hedging does not apply to either:

- (i) Credit institutions, foreign bank branches licensed to provide foreign exchange services (since they already have specialized hedging procedures for foreign exchange)
- (ii) Borrowers who are expected to have sufficient revenue in foreign currency for loan repayment (as also called "natural hedge")

The Draft Circular does not provide any further guidance on how to prove the sufficient revenue.

Furthermore, it is proposed that the foreign currency derivatives bank must present documents on offshore loan to the account bank upon repayment to facilitate the verification of the account bank. Although not clearly stated, it may be understood that the account bank and the foreign currency derivatives bank can be different entities.

This requirement is proposed to be applied retroactively for offshore loan agreements executed prior to the effective date of the Draft Circular in the following cases:

- (i) short-term offshore loan with loan amount of more than USD 500,000 or in other foreign currency of equivalent value signed prior to the effective date of the Draft Circular but have not fully disbursed
- (ii) medium and long-term offshore loans signed prior to the effective date of the Draft Circular but for which the principal has not been fully repaid

2. Particular conditions

a. Purpose of the Loan: Borrowers being credit institutions and foreign bank branches

Borrowers being credit institutions and foreign bank branches can borrow offshore loans for the following purposes:

- (i) To scale up capital to serve the borrower's legitimate business activities. The restriction of short-term loans only being able to be used for supplementing short-term credit capital has been removed from the Draft Circular.
- (ii) To refinance the borrower's existing offshore loan. The requirement of borrowing costs for the new loan not being higher than the cost of the existing loan has been removed from the Draft Circular.

Furthermore, under the Draft Circular, credit institutions and foreign bank branches must also require to satisfy offshore loan limits as follows:

Loan tenor	Applicable ratio	Percentage
Short-term	Maximum ratio of total short-term offshore loans (including contemplated short-term offshore loans) to its owned capital at the last working day of the year preceding the signing date of the loan agreement	In 2023: 25% applicable to credit institutions and 100% applicable to foreign bank branches. From 2024: 20% applicable to credit institutions and 80% applicable to foreign bank branches.
Medium- and long-term	Maximum total net capital draw down (draw down amount minus repayment amount) of medium and long-term offshore loans during the year (including contemplated medium and long-term offshore loans) to its owned capital at the last working day of the month preceding the signing date of the loan agreement	10% applicable to commercial banks. 50% applicable to non-bank credit institutions, foreign bank branches, cooperative banks, policy banks.

b. Purpose of the Loan: Borrower not being credit institutions and foreign bank branches

Changes are made regarding borrowing purposes of borrowers not being credit institutions and foreign bank branches:



- (i) For short-term loans: to repay short-term debts payable within 12 months as from the signing date of the loan agreement, excluding debts arising from both:
- Loan agreements with residents
 - Payment for securities trading, shares/capital contribution, real estate investment and transfer of the project
- (ii) For medium and long-term loan:
- To implement the investment project of the borrower
 - To increase capital to serve for the production and business of the borrower
 - To refinance the borrower's existing offshore loan (borrowing costs are not taken into account)

Also, the SBV also sets stricter rules on offshore borrowing limits as follows:

Loan purpose	Limitation
To implement the investment project of the borrower	Balance of medium and long-term onshore and offshore loans (including contemplated medium and long-term offshore loans to be disbursed) not exceeding the difference between the total investment capital and the contribution capital as recorded in the investment registration certificate or investment policy decision of the borrower
To increase capital to serve for the production and business of the borrower	Balance of medium and long-term onshore and offshore loans (including contemplated medium and long-term offshore loans to be disbursed) not exceeding 3 times of (i) equity according to the latest audited financial statement at the signing date of the offshore loan agreement, or (ii) charter capital (if the equity is lower than the charter capital)
To refinance the borrower's existing offshore loan	The new loan amount not exceeding the principal and interest balance of the offshore loan to be refinanced

3. Others

a. Signing date of the loan agreement

The Draft Circular proposes more flexibility for foreign investors regarding the signing date of the loan agreement. Circular 12 provides that foreign investors must sign the loan agreement **only prior to** draw down date. Under the Draft Circular, the loan agreement can be signed **either prior to or on** the draw down date.

The loan agreement can only be executed on the draw down date in the cases where (i) a credit institution, foreign bank branch borrows an offshore short-term loan, or (ii) the capital transferred to Vietnam by foreign investors for payment of investment preparation costs is converted into offshore loan by the invested enterprises.

b. Transitional provisions

Under the Draft Circular, offshore loans executed prior to the effective date of the Draft Circular may continue to be implemented according to their original terms, but that any amendments to which may only take effect if such amendments meet the new conditions under the Draft Circular.

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The proposals under the Draft Circular are still in draft form, and the final contents are subject to further review and approved by the government. If you would like to discuss the details of the Draft Circular and their impact on your business, please do not hesitate to contact us.



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