

June 2022 | Vol. 14

MHM VIETNAM

Newsletter

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CIRCULAR OF THE STATE BANK OF VIETNAM ON THE CONDITIONS APPLICABLE TO ENTERPRISES' FOREIGN LOANS NOT GUARANTEED BY THE GOVERNMENT

On 11 May 2022, the State Bank of Vietnam ("**SBV**") published a draft circular on the conditions applicable to enterprises' foreign loans not guaranteed by the Government (the "**Draft Circular**"), to collect public opinions. If adopted by the SBV, this Draft Circular will replace the regulations on borrowing under foreign loans currently stipulated under Circular 12/2014/TT-NHNN of the SBV ("**Circular 12**").

The Draft Circular introduces several new requirements, notably caps on borrowing expenses and requirements for foreign exchange derivative transactions.

1. Cap on borrowing expenses

Under Circular 12, the SBV may from time to time impose a ceiling on the borrowing expenses of foreign loans. To date, no cap has ever been imposed.

Under the Draft Circular, caps on borrowing expenses are proposed to be imposed for all foreign loans (whether short-, medium- or long-term). The applicable caps are as follows:

- In the case of foreign loans denominated in a foreign currency, the borrowing expenses must not exceed (i) the reference rate agreed by the parties under the loan agreements plus 8% per annum; or (ii) the 6-month SOFR Term Rate plus 8% per annum (if no reference rate is used).
- In the case of foreign loans denominated in Vietnam Dong, the borrowing expenses must not

exceed the interest rate of Vietnam Government bonds plus 8% per annum.

Specifically, under the Draft Circular, the cap applies to the annual total of the prescribed expenses payable by the borrower expressed as a percentage of the total loan amount. Prescribed expenses include interest charges, internal rates of return and other costs and fees payable to the lenders, guarantors, insurers, agents and other parties, but does not include interest on late payments, commitment fees, break costs, costs relating to foreign exchange and interest rate derivatives transactions (as described below) and foreign contractor taxes.

The borrower is required to prepare a table of borrowing expenses estimated at the time of signing the loan agreement and re-formulate it to include any amendments to the loan agreement related to the borrowing expenses. For medium and long-term foreign loans, the borrower is required to submit this table together with its application for the registration of the foreign loan to the SBV. For short-term foreign loans, which are not required to be registered with the SBV, the borrower will present the table of estimated borrowing expenses to the account bank, which will verify compliance with the cap on borrowing expenses before allowing any drawdown or repayment.

At the same time, the Draft Circular also proposes a relaxation of certain other restrictions on borrowing expenses under Circular 12. Under Circular 12, if the purpose of a foreign loan is to refinance existing foreign loans of the borrower, the borrowing expenses of the new foreign loan must not exceed the borrowing expenses of the existing loans. This restriction is proposed to be lifted in the Draft Circular.

2. Foreign exchange (FX) derivative transaction

Under the Draft Circular, a borrower would be required to enter into a derivative transaction for the purpose of hedging foreign exchange risks. In particular:

- For short-term foreign loans with the total loan amount of more than USD 500,000 (or equivalent amount in other currencies), the borrower must enter into FX derivative transactions with a value of at least 30 per cent of each drawdown amount. The FX derivative transactions must be entered into on or before the applicable drawdown date.
- For medium or long-term foreign loan, the borrower must enter into an FX derivative transaction for each repayment instalment of principal which is more than USD 500,000 (or equivalent amount in other currencies). The value of the FX derivative transaction must be at least 30 per cent of the instalment amount. The FX derivative transaction must be entered into at least three months before the relevant repayment date.

This requirement for FX derivative transaction does not apply to borrowers who are credit institutions, foreign bank branches licensed to provide FX services and borrowers who are

expected to have sufficient revenues in foreign currency for loan repayments. Please note that the Draft Circular does not provide any guidance on how a borrower could prove that it has sufficient revenues in foreign currency for loan repayments. Further clarification of this may be provided in future by the SBV during the implementation of the Draft Circular.

3. Borrowing limit applicable to credit institutions and foreign bank branches

Currently, no borrowing limit is imposed under Circular 12. The Draft Circular proposes borrowing limits for all loans (whether short-, medium- or long-term) for borrowers who are credit institutions or foreign bank branches. Specifically, under the Draft Circular:

- For short-term loans, the borrower would be required to ensure that the percentage of outstanding short-term loans to its equity capital did not exceed 25 per cent if it is a credit institution or 100 per cent if it is a foreign bank branch in 2023. From 2024, the limit is proposed to be 20 per cent and 80 per cent, respectively.
- For medium- or long-term loans, the total net loan drawdown (that is, the sum of the repayment amounts minus the sum of the drawdown amounts) as a per cent of the borrower's equity capital must not exceed 10 per cent for credit institutions, and 50 per cent for non-bank financial institutions and foreign bank branches.

4. Borrowing limit applicable to other enterprises

The Draft Circular also proposes new conditions applicable to enterprises that are not credit institutions or foreign bank branches.

For medium and long-term loans, only the following loan purposes are permitted:

- to implement the investment project of the borrower;
- to increase the capital scale available for the business and manufacturing activities of the borrower; and
- to refinance the borrower's existing foreign loans.

In respect of the first purpose, the loan balance would not be permitted to exceed the difference between the total investment capital and the equity capital recorded in the investment registration certificate or the in-principle investment approval for the project. This borrowing limit is similar to the existing provisions of Circular 12 in the case where a borrower has an investment registration certificate or in-principle investment approval.

Additional borrowing limits are imposed for the other two purposes. In particular:

- The borrower must ensure that the ratio of the loan balance of all medium or long-term loans for the purpose of the business and manufacturing activities of the borrower (whether

under domestic or foreign loans) to its equity capital does not exceed 3:1. Under Circular 12, no specific limitation based on the ratio of the borrowings to the equity capital is prescribed in the case where the borrower has no investment registration certificate or in-principle investment approval for the project, and so the borrower can rely on its funds demand in accordance with its business plan (although the SBV may request the borrower to clarify the reasonable relationship between the business plan and the foreign loan amount).

- The new loan amount used to refinance the borrower's existing foreign loans must not exceed the principal and interest balance of the existing refinanced foreign loans.

The Draft Circular proposes to allow enterprises to borrow short-term foreign loans to settle short-term liabilities that are payable within 12 months from the execution of the relevant loan agreements. However, enterprises are expressly prohibited from borrowing short-term foreign loans to refinance short-term onshore loans, or to settle liabilities arising from investments in securities, purchases stakes, investments in real estates and other projects. In the proposal for the Draft Circular, the SBV explains that this restriction is to prevent liquidity risks and asset price bubbles which may result in macroeconomic instability.

5. Enforcement of security

Foreign lenders would be required under the Draft Circular to appoint an enforcement agent (being a credit institution, foreign bank branch or other legal person established and operating in Vietnam) to enforce security over assets located in Vietnam. This requirement is not proposed to apply where the parties have agreed that the secured party will take over the secured assets in the event of default.

The Draft Circular is still under discussion and will be subject to further review and revision. Although there is no timeline for its finalisation and issuance, the development and finalisation of this Draft Circular will be important for Vietnamese financings.

If you have any questions or would like further details regarding this issue, please contact our lawyers listed in the left-hand column.

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