To fulfil its purpose

The concerns surrounding Vietnam's corporate bond market must be remedied for it to properly act as a financing source.

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The Ministry of Finance (MoF) has proposed two major changes to Vietnam's corporate bond market: prohibiting individual investors from buying privately-placed bonds, and requiring that publicly-issued bonds are backed by collateral. The proposals have sparked a degree of debate, with some experts agreeing that the measures would protect individual investors, who tend to have lower risk tolerance, while others criticize the approach as being too rigid and lacking flexibility in what is still an evolving market.

Public input is now being sought by the MoF on a broader draft law that includes amendments to seven laws covering securities, accounting, tax management, and public asset management. These two main bond market proposals aim to shield individual investors, who often face disadvantages compared to institutional investors, even if they have substantial financial resources.

Loopholes and market impact

While the policy's intent to protect individuals is valid, experts point out loopholes that could still be exploited. They suggest that in addition to restricting individual investments, the MoF should also implement broader solutions to attract institutional investors, like insurance companies and fund managers, preventing the bond market from becoming frozen.

For long-term sustainability, they recommend enhancing market infrastructure by bolstering credit ratings, developing a more active secondary market, establishing bond pricing mechanisms, and shifting regulatory approaches from administrative control to risk-based management. Such measures would strengthen the bond market's role in providing medium and long-term capital for the economy, easing the pressure on the banking system.

Mr. Nguyen Duc Hai, Director and Head of Fixed Income at Manulife Asset Management (Vietnam), emphasized that institutional investors have dedicated teams that assess financial conditions, business plans, and credit ratings before making investment decisions. These processes involve significant cost but lead to more informed investments. In contrast, individual investors often make decisions based on emotion, quickly forgetting past risks.

He argues that restricting individual participation in privately-placed bonds is necessary to prevent a repeat of past market crises, where many individuals, attracted by high interest rates, invested recklessly. While individuals should be allowed to participate in publicly-issued bonds due to higher transparency and standardized conditions, privately-placed bonds carry greater risks.

Lawyer Nguyen Thanh Ha, Chairman of SBLaw, highlighted the vulnerabilities of individual investors by referencing past cases, such as the Tan Hoang Minh scandal, where thousands of individual bondholders became victims. This, along with other corporate bond market incidents, underscores the limited ability of individual investors to recognize and absorb financial risks. Over 6,600 individuals were identified as victims in that case, illustrating the dangers individual investors face in a volatile market.

While acknowledging the rationale behind the MoF proposal, Mr. Nguyen Ba Hung, the Asian Development Bank (ADB)'s Principal Country Economist at the Vietnam Resident Mission, cautioned that it represents a short-term administrative fix rather than a sustainable market-based solution. He explained that bonds, as fixed-income products, are typically attractive to individual investors because of their clear interest rates, unlike stocks, which carry more uncertainty.

In a healthy financial market, there should be diverse products to meet the needs of all investor groups. By relying on administrative measures, the MoF risks encouraging some market players to seek ways to circumvent the rules. For example, individuals may establish single-member companies to invest in bonds, bypassing any restrictions.

To build a resilient corporate bond market, experts recommend strengthening market infrastructure, enhancing credit rating systems, and improving investor education. Mr. Hung urged regulatory authorities to focus on better communications so that individual investors are fully informed about risks and can take full responsibility for their decisions.

He compared the bond market to the stock market, where losses are seen as part of the investment process, with individual investors accepting responsibility for gains and losses without blaming intermediaries. This cultural shift in understanding risk is essential for the long-term health of Vietnam's corporate bond market.

Opening up the market

Individual investors currently dominate Vietnam's corporate bond market, holding a larger share than institutional investors like insurance companies and fund managers. There are concerns that banning individual investors from purchasing corporate bonds would actually lead to market stagnation.

Experts believe that the MoF should

remove barriers and encourage stronger participation from insurance companies and fund managers in the bond market.

From an investor perspective, Mr. Hai said that while banning individuals from private bond placements is reasonable, the challenge lies in the overly strict regulations on institutional investors. For instance, insurance fund managers cannot invest in debt restructuring bonds due to the unclear definition of "restructuring", which conflates refinancing with restructuring.

He explained that banks usually finance risky early stages of renewable energy projects, while insurance companies are ready to step in once projects stabilize. However, regulations prevent insurance firms from buying such bonds, classifying them as "debt restructuring".

Open-ended bond funds also face restrictions, with only 10 per cent of assets allowed in certain types of bonds, leaving 90 per cent being limited to listed bonds. This constrains fund managers, even when unlisted bonds may be suitable investments. Mr. Hai questioned the value of such funds if they are limited to low-interest savings, which are further diminished by taxes and fees.

Meanwhile, Mr. Hung from ADB pointed out that the lack of risk management mechanisms leads regulators to impose blanket bans, which oversimplifies management. He argued that institutional investors, with their risk assessment capabilities, don't need such restrictions to avoid bad investments. He also noted that life insurance companies, despite having long-term capital advantages, aren't fully utilizing their potential in the bond market due to these constraints.

Boosting collateral requirements

Proposed changes to the Law on Securities include a requirement that bonds issued to the public must be backed by collateral. Mr. Ha identified two key advantages in such a proposal.

First, having collateral offers investors added security. If the issuer encounters financial trouble or defaults, investors have a better chance of recovering their capital and interest. Given recent financial market risks, this requirement would increase transparency, reduce risk for investors, and encourage issuers to manage their finances more responsibly.

Second, bonds without collateral rely heavily on the issuer's reputation. Collateral-backed bonds, however, offer investors greater safety since the bond's value is supported by tangible assets. This can help lower the risk of credit default.

However, he also cautioned that the value of collateral can fall over time or be impacted by market fluctuations. If the asset loses value or lacks liquidity, investors could still face financial losses in the event of a default. Additionally, handling collateral is often complex, even for banks, especially when multiple bondholders share the same asset.

Along with collateral requirements, experts urge the government to strengthen credit rating practices. In many countries, credit ratings are mandatory for debt instruments and issuers, which helps increase transparency and protect investors. In Vietnam, however, almost no bonds are rated, while in Southeast Asia more than 50 per cent are.

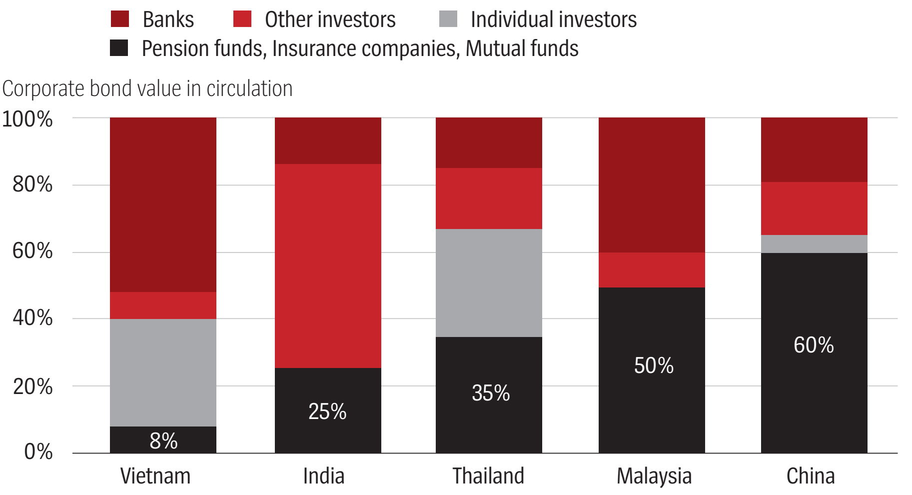
Mr. Ha noted that while Decree No. 155/2020/ND-CP addresses bond credit ratings, Decree No. 65/2022/ND-CP only covers issuer ratings and does not require ratings for debt instruments. This is problematic, because investors are mainly buying specific bond issues not just relying on the issuer's overall rating.

In contrast, the US Securities and Exchange Commission (SEC) requires bond issuers to disclose ratings from recognized agencies. The EU also mandates transparency and conflict-of-interest standards for rating agencies under its Credit Rating Agency (CRA) Regulation, which is monitored by the European Securities and Markets Authority (ESMA). Singapore, Japan, and Australia similarly require issuers to disclose credit ratings, giving investors clearer insights into the risk.

Vietnam's lack of rated bonds limits investor access to important information and slows the bond market's growth. Globally, the International Organization of Securities Commissions (IOSCO) has set principles for managing conflicts of interest and ensuring accountability in credit rating agencies. Leading agencies like Moody's, Standard & Poor's, and Fitch Ratings play a vital role in providing risk assessments worldwide.

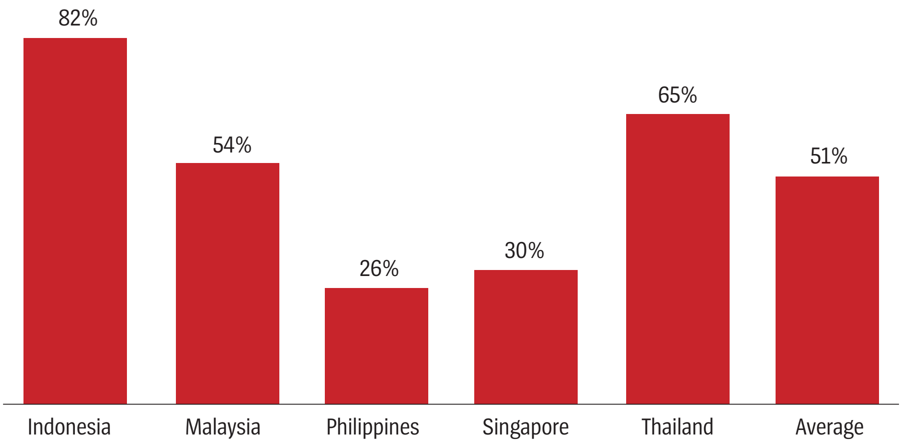
While each country has specific regulations, the global aim of credit rating systems is to ensure transparency, fairness, and independence, helping protect investors and stabilize financial markets. ■

Corporate bond market lacks investor diversity



Source: Asian Bonds Online, Ministry of Finance

Percentage of corporate bonds debt rated in ASEAN countries



Source: CGIF