

Special Alert

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New draft decree on private placement of corporate bonds

Since 2018, the corporate bond market, especially the market for privately-placed corporate bonds ("PPCBs") has experienced significant growth. The volume of corporate bonds issued has reportedly reached VND658,009 billion in 2021, of which PPCBs account for over 95% with a total value of VND627,844 billion, witnessing an increase of 46% as compared to 2020. However, recent misconduct in private placement of corporate bonds has revealed many potential risks to the corporate bond market and the national financial system.

Accordingly, the Ministry of Finance has developed a draft decree to amend and supplement a number of provisions from Decree No. 153/2020/ND-CP. On 20 April 2022, the Ministry of Finance submitted to the Government a draft of the 5th version (the "**Draft**") with newly added regulations that cannot be found in previous versions.

Additional guidance on determining conditions for private placement of bonds

According to the statistics recorded by the Hanoi Stock Exchange, out of 380 enterprises that issue PPCBs in 2021, there were 57 issuers with loss-making business results prior to issuance; 45 enterprises which had a debt-to-equity ratio greater than 10 and 51 issuers of which the size of their issuance of PPCBs exceeded at least fivefold their equity. The fact that businesses without stable financial health succeeded in raising capital from the PPCBs market poses several risks for investors holding bonds of these enterprises, and also for the security of national finance.

To address this, the National Financial Supervisory Commission has proposed additional conditions for offering private placement of corporate bonds to avoid cases when enterprises without a secured ability to repay debt to be able to raise capital from the corporate bond market. Acknowledging these comments, the Draft has obtained additional regulations guiding the conditions of offering as follows:

- *Limits on mobilizing from bond channels:* The draft sets a threshold limit for issuance of corporate bonds (including issue size of bonds projected for later issuance) of enterprises at three times the amount of equity;
- *Ensuring the debt repayment capacity of the issuer:*
 - Enterprises that issue PPCBs must have profitable production and business results in the year preceding the year of issuance, and no accumulated losses according to audited financial statements;
 - For enterprises with a total debt loan to equity ratio greater than one, the Draft requires collateral or payment guarantee when issuing additional bonds.

Additional regulations to provide protection for retail investors

The rate of individual investors buying corporate bonds in the primary market only accounts for a modest proportion of 5.39% of the total issued bonds. However, on the secondary market, individual investors hold up to 26.3% of bonds that were issued in 2021, most of which were later redistributed by securities companies. In the PPCBs market, individual investors hold up to 43.1% of the issue size of PPCBs as of 31 December 2021.

In order to meet conditions for trading PPCBs under Decree No. 153/2020/ND-CP ("**Decree 153**"), parties found ways to circumvent applicable regulations regarding identification of professional securities investors being individuals by common methods such as (i) buying and selling securities in a short period of time to be regarded as a professional securities investor; (ii) use of a margin account to circumvent regulations on investment portfolio's minimum value; or (iii) participation in agreements on capital contribution for investing in corporate bonds with organizations in accordance with the civil law (for the notorious case of Tan Hoang Minh).

To prevent these situations, the Draft has added a number of regulations guided by the following two principles:

- *Limiting types of private placement of corporate bonds that can be traded:* Regulating that investors being individuals are only allowed to invest in PPCBs issued by public companies, and secured by collateral or payment guarantees;
- *Adjustment of factors determining the status of a professional securities investor:* the required period to maintain the investment portfolio (exclusive of securities from margin accounts) with a minimum value of VND2 billion to be at least two consecutive years before making an investment in PPCBs.

Additional obligations for issuers to comply

In the PPCBs market, investors and, especially retail investors, are always exposed to various risks

due to limited access to information and thus are easily lured by high interest rates. In addition, investors also face many other risks when the current legal system still lacks strict regulations in risk reduction mechanisms when issuers fail to comply with issuance plans.

In order to ensure that the issuer complies with the issuance plan announced to investors, the Draft includes provisions in the following directions:

- *Redeem responsibility of the issuer:* investors have the right to request repurchase of PPCBs before the due date by voting at the general meeting of bondholders in case an issuer is found to have violated its issuance plan or applicable laws on private placement.
- *Valuation and registration of collateral:* the collateral assets for private placement of corporate bonds are mostly assets formed in the future or shares of the issuer, both are exposed to strong fluctuation of value according to the market, which tend to be potentially risky for investors. Therefore, in order to limit the risks of security assets, the Draft requires the issuer to conduct valuation of the security assets and register security measures in accordance with the law.
- *Adding components to the offering document:* to ensure that the issuer uses the money utilized from PPCBs, the Draft requires the issuer to sign a contract with a bank in management of the account of the proceeds utilized from bond issuance. In the circumstance when PPCBs are issued to professional securities investors being individuals, the issuer is required to sign a contract with the Bondholder's Representative.

However, Bondholders Representatives will not be able to act as practically as hoped because the majority of PPCBs are initially offered to securities companies, and then redistributed to individual investors in the secondary market.

Regulations to improve the transparency of the market of private placement of corporate bonds

- *Supplementing regulations on offering consultant:* Decree 153 stipulates that securities companies providing consulting services on offering files are obliged to review satisfaction of conditions and dossiers for private placement. However, profiting from issuance consulting services has led securities companies to build bond offer files and disclose information based on what is beneficial to the issuer. In order to limit the above conflicts of interest, the Draft set forth the following new provisions:
 - offering consultant must not be a related person to the issuer;
 - acts of providing false information and selling bonds to investors not in compliance with the law are prescribed as prohibited acts.
- *Supplementing regulations on periodic reports:* Issuers are required to make periodic reports

on the use of proceeds utilized from issued bonds, performance of commitments, and schedules on payment of principal and interest to investors and to the Stock Exchange on periodic bases. The Stock Exchange will have this information which it can compile and publish on a portal of PPCBs, especially information on issuers who commit violations so that investors have a reliable source of information to assess the level of risk before deciding to invest in corporate bonds.

Epilogue

Despite the fact that the Draft no longer requires issuers to perform credit ratings when issuing private placement of corporate bonds, it has not yet completely resolved the controversial regulations on issuing purpose. On the part of legislators, the regulations on issuance purposes are intended to limit abuses in the form of transferring capital in a "circle" between enterprises to circumvent regulations on credit limits, threshold on issue size, etc., which can lead to systemic consequences when any piece of the chain breaks down. However, many experts still concern that this regulation is not consistent with the principles of governance of corporations and groups of companies, and with the principle of self-borrowing and self-payment under Decree 153.

In addition, new regulations proposed in this Draft also set further requirements for issuers, leaving experts even more concerned that only a few domestic enterprises will be able to meet the requirements set forth. Therefore, relevant authorities need to make prudent and comprehensive assessment of the impact that proposed regulations may cause before they are put into practice so as not to cause interruption to business operations and the economy as a whole.

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