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## **Strengthening Bad Debt Handling at Vietnam Joint Stock Commercial Bank for Foreign Trade**

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### **Abstract**

Bad debt is one of the factors that greatly affects the operations of commercial banks, especially in Vietnam, credit still accounts for the highest proportion of total assets, providing the largest source of income but also the activities that bring the most risk to the Bank. The formation of bad debt not only hinders the healthy development of the banking system but also affects commercial banks, the economy... thereby causing economic recession and giving rise to many social problems. Other association. When a bank has too high a bad debt ratio, it can fall into a state of insolvency, leading to failure. A failed bank can cause a

domino effect on the entire system.

Joint Stock Commercial Bank for Foreign Trade of Vietnam (Vietcombank) is currently the most effective bank in the Vietnamese banking system. However, during the operation process, Vietcombank still faces the problem of bad debt.

Therefore, on the basis of analyzing the current situation of bad debt handling at Vietcombank in Vietnam in recent times, the article offers some recommendations to remove some bottlenecks in bad debt handling at Vietcombank in the coming time.

**Keywords:** Bad Debt, Vietcombank, Bad Debt Handling

### **1. Introduction**

Bad debt is an inevitable part of commercial banking activities in a market economy, and is a major problem in the process of financial health of commercial banks.

In lending activities, bad debt is a big challenge for commercial banks. It happens when the customer cannot repay the loan on time or fails to repay the loan. That leads to bad debts accumulating and can cause losses in assets and profits of the bank.

The process of increasingly deep integration into the international financial system puts Vietnam Joint Stock Commercial Bank for Foreign Trade at higher risks and suffers more severe impacts, so the risk of bad debt also increases. increasing direction. During operations, bad debt can clog Vietcombank's credit flow.

The problem of handling bad debt requires Vietcombank to find effective methods to minimize the negative impact of bad debt on the bank's lending activities, reduce risks and enhance sustainability in the future.

### **2. Theoretical basis for bad debt and bad debt handling**

#### **\* Bad debt**

Bad debt is money that banks lend to customers, but when the debt is due to be recovered, it cannot be recovered due to subjective factors from the customer's side such as businesses and credit institutions making losses or going bankrupt. assets leading to the bank's inability to repay the loan when it comes due.

According to the International Monetary Organization (IMF), a loan is considered bad debt when principal or interest payments are overdue for 90 days or more, when interest payments that are overdue for 90 days or more have been capitalized and restructured. deferred, or delayed by agreement, when payments are due in less than 90 days but there are clear signs that the borrower will not repay the loan in full. Basically, bad debt is determined based on two factors: (i) overdue for more than 90 days or (ii) doubtful ability to repay<sup>[5]</sup>.

In Vietnam, according to Circular 12/2021/TT - NHNN dated July 30, 2021 of the State Bank of Vietnam<sup>[1]</sup>, bad debt is debt in groups 3 (Substandard debt), 4 (Doubtful debt). doubtful) and 5 (Debt with potential loss of capital). Bad debt includes all debts classified into groups 3 to 5 depending on different risk levels, on the principle that only one loan (out of many other

loans) is overdue, or If the debt term is adjusted or the debt is extended, the entire outstanding debt of that customer must be transferred to the bad debt group. Thus, bad debt according to Vietnamese law is determined by two factors: (i) overdue for more than 91 days or (ii) worrying ability to repay debt.

#### \* Handling bad debt

Handling bad debts in commercial bank lending activities means commercial banks use financial measures and legal tools to reduce the ratio of debts considered bad debts of the bank, contributing to healthy financial situation and improving the competitiveness of each bank in the economy. Accordingly, handling bad debts in lending activities of commercial banks is only a technical and professional job of each individual bank, so handling bad debts is only proactively carried out by each bank, existing and not dependent on the State or other entities.

### 3. Research methods

The article uses qualitative research methods including two basic methods: data collection, synthesis and analysis and evaluation. Based on the synthesis of data related to the current bad debt situation at Vietcombank, the article offers some solutions to enhance bad debt handling at Vietcombank in the coming time.

### 4. Current bad debt situation of Vietnam Joint Stock Commercial Bank for Foreign Trade

#### 4.1 Results achieved in the process of controlling bad debt of Vietnam Joint Stock Commercial Bank for Foreign Trade

In 2022, Vietcombank will control credit quality well when group 2 outstanding debt is VND 3,289 billion, group 2 debt ratio is at 0.29%, down 0.08 percentage points compared to 2021 (0.36%). Bad debt balance is 7,662 billion VND, bad debt ratio is at 0.67%, lower than the assigned plan. The risk reserve fund balance is VND 35,603 billion. The on-balance sheet bad debt provision ratio reached the highest level in the banking system (~ 465%)<sup>[6]</sup>.

#### 4.2 Limitations in the process of controlling bad debt of Vietnam Joint Stock Commercial Bank for Foreign Trade

Vietcombank - a bank often in the group with good asset quality in the industry. Vietcombank's motivation for profit growth in the third quarter of 2023 mainly comes from reducing credit risk provisioning costs. However, cutting this amount means that the bank's bad debt coverage ratio drops sharply, and bad debt also increases rapidly.

Despite recording positive business results when pre-tax profit increased by 18% in the context of many banks' profit decline, bad debt at Vietcombank also increased sharply, especially group 3 and group 4 debt. Vietcombank has more than 6,500 billion VND in bad debt after the first 3 quarters of the year, equivalent to an increase of 84%. Of which, group 2 debt (debt that needs attention) increased by 87.5%; Group 3 debt (substandard debt) is 7.1 times higher; Group 4 debt (doubtful debt) is 7.3 times the figure at the end of last year while group 5 debt is down 14%.

Bad debt increased sharply, but due to reduced credit risk provisions, the bank had to increase risk provisions by nearly 38,872 billion VND (equivalent to 57%) and Vietcombank's bad debt coverage ratio decreased to 270%. a

sharp decrease compared to 385% at the end of the second quarter of 2023<sup>[6]</sup>.

*The reasons leading to the increase in bad debt of Vietcombank include:*

#### - Group of objective causes:

**First**, the legal framework related to bad debt handling is incomplete, lacking preferential mechanisms and policies to encourage domestic and foreign investors to participate in handling collateral and debt trading, bad. In particular, the real estate market continues to have low liquidity, causing difficulties in handling secured assets.

**Second**, many changes in macroeconomic policies have directly affected borrowers, leaving them in a passive position. Therefore, it indirectly affects debt quality, causing bad debts at banks to not be resolved and bad debts to form. The State's macro management policies are in the process of innovation and improvement, so there are often adjustments and changes that make many businesses unable to keep up, leading to inaccurate market demand forecasts. It is this frequent change that causes businesses with loans at banks to have their bank debt repayment plans as well as other business plans disrupted.

In fact, Vietcombank is a state-owned enterprise that is facing many difficulties such as: loss of product consumption market, fluctuations in prices and markets, and due to factors such as business restructuring, mergers, Dissolved and bankrupt but are unable to pay outstanding debts or no longer have subjects to collect debts. The risks and losses caused by these causes are also beyond the will of the borrower.

**Third**, unreasonable credit policies that fail to promote superiority are also a big reason why bad debt always exists at Vietcombank. Weaknesses of lending policies are also the direct and profound cause of bad debt. Lending activities for one purpose, under the direction of the Government or according to the State's plan have caused huge risks to banks. Some programs were built but lacked scientific basis as well as practicality, leading to inadequacies between supply and demand, causing bad debts that hindered Vietcombank's operations.

**Fourth**, due to the difficulties of businesses after a long period of the Covid-19 pandemic, along with the unstable impact of the world economy. The impact of the pandemic combined with increased inflation makes the overall demand of the world as well as Vietnam very weak, affecting the production and business activities of the business community.

Vietcombank's bad debt handling in recent times has still faced many difficulties because businesses are suffering from negative impacts from the external environment, reducing their ability to repay debt.

**Fifth**, many customers have the idea of taking advantage of loopholes in the law to attempt fraud, use loan capital for the wrong purpose, and borrow with no intention of repaying the debt.

#### - Group of subjective reasons:

**First**, the business strategy lacks durability and effectiveness. Some credit activities at Vietcombank still follow market signals. Vietcombank has poured a large amount of capital into sensitive investment fields such as real estate or securities... despite knowing that the market in these fields sometimes overheats, sometimes freezes,

causing debt backlog.

**Second**, the distinction between the appraisal and lending stages at Vietcombank is still not really clear. Appraisal and lending are still done by the same credit officer, then through the control of the credit department leader and loan approval director, the steps of approaching documents and submitting information documents are mainly based on information provided by customers for appraisal. Members of the Credit Council are hardly experts in the field, time to read and research documents is still limited to the provision of credit officers. Hiring experts in fields with little understanding is almost non-existent. In addition, the binding of responsibilities of the consultant is not strict, the bank only relies on the appraisal of the authorities often. Being the owner of the business leads to "agreement" between the parties to borrow bank capital becoming popular today.

**Third**, the management, evaluation, and selection of collateral assets are still weak. Managing the collateral portfolio is an important step in the management of state-owned commercial banks. For Vietnam, legal regulations already exist and are implemented to a certain extent, but the management, evaluation, classification, forecasting, and warning of the list of assets that a commercial bank has. The commercial selection, prioritization, and acceptance of loan guarantees are not consistent, but only stop at the periodic inspection of legal documents and reassessment of value to adjust the loan balance or request customers additional collateral.

**Fourth**, some Vietcombank credit officers did not comply strictly and had poor professional understanding, leading to intentional or unintentional wrongdoing.

In addition, the qualifications, management and operational experience of officers and leaders of the commercial banking system are still slow to detect potential risks, leading to mistakes in regulations for banks. Loans and credit quality are not good for a long time. The policy mechanism is still loose without strict rewards and punishments, and individuals are ultimately responsible for debts they lend that cannot be recovered, creating low credit quality.

## 5. Solutions to enhance bad debt handling at Vietcombank

To handle bad debt, in the coming time, Vietcombank needs to take the following measures:

**First**, comply with regulations on ensuring safety in commercial bank operations.

Regulations on ensuring safety in the operations of credit institutions include overall regulations on minimum capital adequacy ratio, loan limits, solvency ratio, credit granting ratio. This is one of the very important risk mitigation measures that not only ensures safety in Vietcombank's operations, but also enhances banking competitiveness, contributing to socio-economic development.

**Second**, use loan security measures.

Loan security is one of the important tools to limit risks in lending activities. Effective loan security measures are using collateral, pledging or having a guarantee from a third person. In case the customer cannot repay the loan capital and interest, Vietcombank can sell collateral to compensate for its losses caused by the loan. In addition, the bank may require customers to open an account at their bank and deposit a minimum loan amount equal to, for example, 10%

of the value of the loan as a backup. In this way, Vietcombank can monitor borrowers more effectively, while also helping to increase repayment ability. In case the borrower defaults, the bank takes that portion to compensate for part of the loan lost during the lending process.

**Third**, classify customers to apply appropriate debt handling measures

Bad debt is an inevitable part of banking operations. To limit risks in lending activities, Vietcombank needs to screen customers by gathering reliable information about good customers. Based on the information collected, Vietcombank calculates credit scores, evaluates and classifies customers as having good or bad prospects to decide on credit granting.

To handle bad debt effectively, Vietcombank needs to divide into two groups of customers to have different behavioral measures and implement solutions:

(i) Support customers to repay debt in accordance with their ability to repay (debt structure), debt repayment plan (reduction, exemption of loan interest).

- For groups of customers who are willing to cooperate and have sources to repay debt, Vietcombank considers combining many measures to support and encourage customers to repay debt such as debt structure suitable to debt repayment ability, reducing and waiving loan interest. Share difficulties during the epidemic.
- For customers who have goodwill but do not have enough resources to repay debt, Vietcombank requires customers to coordinate agreements on handling secured assets. Prioritize the auction method, on the principle that the selling price/starting price of the auction must be close to the market value of the asset and reduce the price by a maximum of 10% and shorten the auction.

In addition, Vietcombank can reduce or waive interest rates. This measure is applied to reduce financial difficulties for customers, create conditions for customers to restore production and business activities, and encourage customers to pay a part or all of the remaining bad debt at the bank.

- For customers in the group of customers who are not willing to cooperate, Vietcombank resolutely applies strong and drastic recovery measures such as: seizing and handling security assets according to Resolution 42<sup>[4]</sup>; initiate a lawsuit (priority is given to mediation); Regularly discuss with the Judgment Enforcement agency to enforce the sale of secured assets.
- In case the customer is inattentive, intentionally evading, or shows signs of violating the law, the file will be transferred to the police for handling. This is the last measure applied by the Bank after applying the above measures but is not effective in debt collection.

(ii) Agreements with customers such as: agreements to handle secured assets quickly and effectively; Mediation in court to shorten litigation time...

Based on the results of periodic debt classification, banks need to review and develop plans to handle and recover bad debts according to each specific measure. Accordingly, debt collection measures directly from customers and debt recovery through the sale of secured assets are given top priority. Vietcombank needs to strengthen review and assessment of business operations, collateral, and customers' ability to repay debt; Closely monitor debt restructuring customer portfolio; promptly have appropriate credit

behavior to limit arising bad debts.

**Fourth**, handle bad debt in bank lending activities by debt restructuring measures.

Debt restructuring is a measure used when a debt is due for repayment but the bank assesses that the customer is unlikely to be able to repay the bank according to the previously signed repayment schedule due to the customer having difficulty in paying the debt. production and business, however, if the Bank restructures the debt repayment period, customers will be fully capable of repaying the bank on time.

**Fifth**, sell debt, especially large and complex debts.

The advantage of the debt sale method is that the debt is completely resolved and completely transferred to the debt buyer. Selling debt is also considered the fastest solution to handle bad debt, helping creditors recover part of their business capital to serve new business needs and opportunities, in order to improve the financial situation. However, when applying this measure, banks often have to accept the resale of debts at a value lower than the current debt collection rights, thereby causing certain losses to the bank's business results.

**Sixth**, handle bad debts in bank lending activities by setting aside and using risk reserve funds. Follow Circular No. 12/2021/TT - NHNN dated July 30, 2021 of the State Bank <sup>[1]</sup> regulations on debt classification, provisioning and risk handling.

Establishing a risk reserve fund is considered one of the important measures to increase the bank's ability to withstand risks, helping the bank to stabilize and develop business operations in case risks occur.

**Seventh**, carry out digital transformation and apply information technology to support debt processing and collection.

## 6. Conclusion

Bad debt in commercial bank lending activities is a major problem that causes risks and negatively affects Vietcombank's operations. Bad debt can cause loss of assets and profits and needs to be handled effectively to ensure sustainable lending operations. To develop safely and effectively, in the coming time, Vietcombank needs to focus on handling bad debt because this is the cause that has a great impact on the efficiency of the bank's business operations, and at the same time causes stagnation. capital circulation in the Vietnamese economy. Improvement and efficiency in bad debt handling will contribute to ensuring Vietcombank's lending activities run smoothly, thereby creating a foundation for the bank's sustainable development.

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