

Vietnam publishes new regulations for derivatives market

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On 1 July 2015, Decree 42/2015/ND-CP (**Decree 42**) became effective. This represents the first phase in setting out the legal framework for trading derivatives securities in Vietnam and is an important step in the development of the derivatives market in Vietnam generally.

1. Background

To date, the derivatives market and related legislation in Vietnam has been in its infancy. Before Decree 42, permissible derivatives were limited to basic currency products such as foreign exchange transactions, interest rate swap transactions and commodity swap transactions entered into for hedging purposes between a Vietnamese bank or a Vietnamese branch of a foreign bank (each licensed under the relevant regulations of the State Bank of Vietnam (**SBV**)) and a Vietnamese counterparty. A licensed Vietnamese bank or a Vietnamese branch of a foreign bank could also enter into cross-border derivative transactions (such as an interest rate swap) with an offshore counterparty depending on the transaction and counterparties involved and subject to approval from SBV which was granted on a case-by-case basis.

There was a change when futures and options were both recognized as concepts under the 2006 Vietnamese Securities Law¹ (**Law on Securities**) which defined them as securities which can be tradable in the securities market. However, the Law on Securities did not provide details on the trading, clearing and settlement of these products.

However, this is now changing. The plan on the development of a regulated market for trading derivatives in Vietnam was approved by the Prime Minister in March 2014, making way for this latest development. Decree 42 was issued on 5 May and came into force on 1 July 2015.

2. Overview

It is expected that the Vietnamese Government will issue various regulations this year aimed at developing

a derivatives market to commence operations in 2016. Decree 42 is the first of these and, in summary, it:

- sets out the types of derivative instruments that will be tradable in the Vietnamese derivatives market (that is, securities-based listed derivative transactions);
- governs the trading, clearance and settlement of these securities-based listed derivative transactions. For example, the settlement of a securities-based listed derivative transaction must be made via clearing members and Vietnam Securities Depository (**VSD**) as central clearing house;
- sets out the requirements and conditions for investors looking to participate in the Vietnamese derivatives market, as well as institutions providing services in relation to derivatives securities trading (such as derivative securities business activities and clearance and settlement services);
- seeks to replicate international standards with respect to certain aspects of derivatives trading, for example, clearing and settlement.

We discuss these in more detail below.

3. Types of Instruments

Under Decree 42, the derivatives instruments permitted to be traded on the regulated market are:

- Future contracts;
- Options;
- Forward contracts where the underlying assets are securities (e.g. shares, bonds and units) traded on a Vietnam Stock Exchange (**Stock Exchange**). Vietnam currently has two stock exchanges; the Hanoi Stock Exchange (**HNX**) and the Ho Chi Minh City Stock Exchange (**HOSE**) which may be consolidated into one stock exchange under a plan of the Ministry of Finance (**MOF**) which has been submitted to the Prime Minister for his approval. This is expected to be passed in the near future; and

¹ As amended by Law No. 62/2010/QH12 dated 24 November 2010.

Other listed or negotiated derivatives securities where the underlying assets are securities traded on the Stock Exchange. The types of derivatives prescribed by Decree 42 seem to only relate to listed derivative instruments. It is not yet clear how over-the-counter (OTC) transactions and less standardised derivative contracts will be treated.

It appears that non-securities derivative transactions, such as interest rate swaps, foreign currency swaps and commodity swaps, are not covered by Decree 42 and will continue to be regulated by the SBV.

4. Who can invest?

Both Vietnamese and foreign entities and individuals can freely invest in the derivative securities market, although each has different conditions and requirements that it will have to comply with.

Vietnamese entities have to satisfy the requirements and conditions specified in Decree 42 before investing and these vary depending on the type of Vietnamese entity involved:

- **A securities companies:** must have a *Certificate of satisfaction* for having met the dealer conditions issued by the State Securities Commission of Vietnam (SSC);
- **A fund management company:** the capital for making derivatives trading must be sourced from entrusted funds of an investment fund or capital of a securities investment company, provided that provisions permitting the use of those capital sources for investment in derivatives are clearly documented in relevant investment portfolio management contract and/or charters of that investment fund or securities investment company (as applicable). The fund management company is not allowed to use its own equity, including loan capital, to invest in derivatives;
- **A credit institution or a Vietnamese branch of a foreign bank:** must have a prior written approval of the SBV to conduct trading in derivative securities;
- **An insurer or a Vietnamese branch of foreign insurer:** must have a prior written approval of the MOF to conduct trading in derivative securities; and
- **A State-Owned Enterprise:** must have a prior written approval of its managing authorities and/or owner.



Note that these requirements and conditions only apply to Vietnamese entities – they do not apply to a foreign entity looking to invest in derivative securities listed on the Stock Exchange although such foreign entities will have to comply with other requirements which we discuss below.

5. Securities derivatives trading

Decree 42 stipulates that all listed derivatives transactions (regardless of whether the investor is a foreign or Vietnamese entity) must be executed via a trading member of the Stock Exchange. Those transactions will then be executed by way of matching an order through the derivatives securities trading system (of the Stock Exchange) or putting through an order between a buyer's trading member and seller's trading member.

A derivatives trading member can only receive an investor's trading order provided such investor has (i) opened a derivatives trading account with that trading member and (ii) placed an escrow deposit (either money or securities) as required by a relevant clearing member (who may also be that trading member – please see below for further details).

Only Vietnamese entities can be trading members. There are two types of trading members, both of which must be Vietnamese:

- **Trading member:** A Vietnamese securities company which is permitted to conduct proprietary trading of derivatives for its own account (i.e. self-trading) and provide derivatives brokerage services (i.e. broker-dealer) and investment consultancy services; and
- **Special trading member:** a Vietnamese commercial bank who is permitted to invest in

derivatives securities where such underlying securities are Government bonds.

In order to be a trading member or special trading member, the following conditions must be satisfied:

- the applicant must not be in the process of consolidation, merger or dissolution; must not be under the control or special control of any Vietnamese authority; and its operation must not be subject to suspension or temporary suspension pursuant to a decision of a Vietnamese authority; and
- the applicant must satisfy the Stock Exchange's requirements on IT infrastructure and professional rules for derivatives trading.

In addition, a securities company must be licensed by the SSC by way of issuance of a *Certificate of satisfaction of conditions for derivatives brokerage* in order to be a derivative securities trading member, while a commercial bank must (i) have SBV's approval on investment in derivatives; and (ii) be a trading member on the Government bond market of the Stock Exchange, in order to be a special trading member.

A trading member/special trading member can be a non-clearing member or a clearing member, provided that it satisfies conditions for being a clearing member set out in Decree 42. If this is the case, it can register to be a market-maker and be a market driving member, who is entitled to create a market for one or more derivatives on the basis of a contract signed with the Stock Exchange.

6. Derivative securities business activities

6.1. What is derivative securities business?

Decree 42 sets out a range of derivative securities



business activities which can be provided by a Vietnamese service vendor:

- Derivative securities brokerage;
- Derivative securities self-trading; and
- Derivative securities investment consultancy.

6.2. Who can conduct derivative securities business activities?

Pursuant to Decree 42, service vendors must be issued with a certificate of satisfaction of conditions for derivative securities trading or a certificate of satisfaction of the derivatives securities broker-dealer conditions, as the case may be, by the SSC. In order to be issued that Certificate, the securities business organization who wishes to be a service vendor with respect to the above must meet the following criteria:

- be licensed for all securities professional business activities in accordance with the Law on Securities;
- meeting the certain requirements on the charter capital and/or owner equity which are corresponding to each of activities as follows:
 - VND600 billion (approx. USD27.5 million) in the case of derivatives self-trading;
 - VND800 billion (approx. USD36.7 million) in the case of derivatives brokerage;
 - no less than the amount of legal capital stipulated by the law of securities in the case of derivatives investment consultancy (i.e. VND10 billion (approx. USD458,715) with respect to provision of securities investment consultancy); and
 - at least VND800 (approx. USD36.7 million) billion in the case of provision of all activities mentioned immediately above.
- satisfying conditions promulgated by the Ministry of Finance on business results, ratios of available capital and professional rules;
- the director/general director and deputy director/deputy general director) in charge of professional activities and at least 5 staff for each derivatives trading activity as proposed for registration, must have (i) securities practicing certificates and (ii) certificates of expertise in derivatives and the derivatives market; and
- not be in the process of consolidation, merger or dissolution; or not be under control or special

control of any Vietnamese authority; or its operation not subject to suspension or temporary suspension pursuant to a decision of a Vietnamese authority.

7. Clearing and Settlement of Derivatives

Listed derivative transactions must be cleared and settled by the central counterparty clearing mechanism (CCP) via the VSD whereby VSD is a party and a clearing member is the other party to those transactions.

A Vietnamese securities company, commercial bank or Vietnamese branch of a foreign bank can be a clearing member. There are two types of clearing members:

- **General clearing member:** who can clear and settle transactions for their own account and for its brokerage clients. General clearing members can also provide clearing and settlement services to non-clearing trading members and their clients; and
- **Direct clearing members:** who can clear and settle transactions for their own account and only for its brokerage clients.

In addition, clearing member must also meet the following requirements:

- be issued a *Certificate for derivatives clearance and payment services* by the SSC. The conditions for

being a clearing member include:

- be a depository member of VSD;
- be permitted by the SBV in writing for derivatives clearance and settlement activities (in the case of a commercial bank or a Vietnamese branch of a foreign bank) or be issued a *Certificate for derivatives brokerage* by the SSC (in the case of a securities company); and
- meeting the required charter capital and/or owner equity as follows:
 - **Direct clearing member:** VND5,000 billion (approx. USD229 million) (in the case of a commercial bank) or VND900 billion (approx. USD41.3 million) (in the case of a securities company); and
 - **General clearing member:** VND7,000 billion (approx. USD321 million) (in the case of a commercial bank) or VND1,200 billion (approx. USD55 million) (in the case of a securities company).
- satisfying the conditions on (i) business results and ratios of available capital in the case of a securities company, (ii) prudential ratios in the case of a commercial bank; and (iii) issued capital in the case of a Vietnamese branch of a



foreign bank;

- having rules on the professional activity of clearing and making payment for derivatives transactions in accordance with guidelines of the MOF; and
- not be in the process of consolidation, merger or dissolution; or not be under control or under special control of any Vietnamese authority; or its operation not be subject to suspension or temporary suspension pursuant to a decision of a Vietnamese authority.
- be a derivative trading member of the Stock Exchange in the case of a securities company; and
- satisfying the requirements of the VSD on IT infrastructure, professional rules and personnel for derivatives clearance.

Decree 42 does not mandate the trading, clearing and settlement of an OTC transaction of a derivative security via the Stock Exchange and VSD (as applicable) unless otherwise agreed by the parties. Nonetheless, the parties are required to report in writing to VSD of such OTC transaction both before and after signing and performing the contract.

Conclusion

This is an important step forward for the nascent derivatives market in Vietnam and represents a changing mindset amongst legislators and regulators which will be of interest to all financial institutions and other market participants with an interest in Vietnam.

There are still some points that we will watch with interest. It appears that Decree 42 applies to the trading, clearing and settlement of securities-based listed derivative transactions only, With the SSC of Vietnam regulating such market participants. The trading, clearance, settlement and performance of contracts in relation to unlisted derivatives will be carried out in accordance with the contractual agreement reached between the parties to the transaction and in compliance with relevant laws governing it. The trading, the clearing and settlement of unlisted derivatives may however be conducted by the Stock Exchange and the VSD, respectively, in accordance with Decree 42. This has resulted in a bifurcation of derivative products - Other non-securities-based derivatives (such as interest rate, foreign currency and commodity swaps) are excluded and will continue to be regulated by the SBV.

Further, Decree 42 does not seem to apply to OTC derivative transactions and it is unclear whether the Government intends to address such transactions in subsequent regulations.

Market watchers will keenly follow the implementation of Decree 42 and await the next wave of regulations and laws which are expected during the course of 2015.



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Further information

If you would like further information on any aspect of this note, please contact:



Samantha Campbell
Managing Partner, Hanoi/Ho Chi Minh City
T +848 3829 5100
samantha.campbell@hoganlovells.com



Long Huynh
Senior Associate, Ho Chi Minh City
T +848 3829 5100
long.huynh@hoganlovells.com



Jeff Olson
Partner, Ho Chi Minh City
T +848 3829 5100
jeff.olson@hoganlovells.com



Davina Chew
Senior Associate, Singapore
T +65 6302 7147
davina.chew@hoganlovells.com



Bronwen May
Partner, Hong Kong
T +852 2840 5630
bronwen.may@hoganlovells.com



Chi Vo
Associate, Ho Chi Minh City
T +848 3829 5100
chi.vo@hoganlovells.com

www.hoganlovells.com

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