

Challenges in the development of Vietnam's payment system

Le Phuong Lan

After a long period under a centrally planned economy, Vietnam is now moving towards a market-oriented economy. In recent years, the country has made significant progress in the process of economic development. Trading transactions throughout the economy have increased, leading to a rise in the demand for payments. Although the bank payment system has been improved considerably, due to the existing technology, legal framework and other infrastructure, the payment system still falls short of the economy's demand for payment transactions. Therefore, the use of non-cash payment instruments is limited. In other words, a significant proportion of payment transactions are carried out in cash. With the current efforts to develop the payment system, we hope that we can gradually put an end to the so-called cash economy. The present paper focuses on the development of the existing payment system, the internal issues and external constraints in the development process and the solutions adopted. It will deal in turn with the development of Vietnam's payment system, the challenges faced in developing the system, and, finally, the solutions envisaged and the future orientation of the system.

Development of the payment system in Vietnam

An overview

The financial sector in Vietnam consists essentially of the banking sector. The State Bank of Vietnam (SBV) was the country's monobank until 1988, when commercial and central banking activities were separated. Financial reform began at the end of the 1980s, extending banking services to include a wide variety of ownership structures. Since then, a large number of financial institutions have been established. The present banking system includes many types of bank: state bank, state-owned commercial bank, joint-stock bank, joint-venture bank, foreign bank branch, credit

cooperative, etc. The total number of branches and bank offices of all types amounts to over 4,500.

The State Bank of Vietnam is the country's central bank, which acts as the regulator and supervisor of the banking system. The SBV's role is steadily evolving as it modernises its operations in the context of a developing market economy.

The SBV has its head office in Hanoi and branches in each of the country's 61 provinces. These branches are also involved in a variety of central banking activities such as supervision and the clearing and settlement of payment transactions.

The commercial banking sector is dominated by four state-owned banks which account for around 80% of commercial bank operations in Vietnam and have the largest number of branches.

The payment system

The intrabank payment system has improved significantly in recent years. Almost all commercial banks are now equipped with modern computer networks. As a result, an intrabank bank funds transfer can be initiated and completed the same day. The presence of foreign banks with modern technology and offering high-quality service means that the domestic commercial banks have no choice but to apply the new technology to their payment systems and enhance the quality of service in order to maintain their competitiveness and market share. Procedures for intrabank payments depend on the degree of computer support available at branch level and on the size of the branch network. In general, commercial banks centralise the processing of inter-branch transfers at one regional centre, and transfer requests are made via computer using dial-up links. Branches effect their transfers via their accounts with the regional centre. Within a province, branches act for sub-branches and make transfers to each other mainly via the postal system. Inter-provincial transfers are sent via dial-up link for processing via accounts held at the head office.

The interbank payment system is now regarded as underdeveloped, despite its recent improvement. The mechanism of this system can be outlined as follows: each branch of a commercial bank has to open a settlement account with the SBV's branch in the province where it is located. The SBV's branches act as provincial clearing centres for the

processing of intra-provincial payment transactions. Intra-provincial interbank transfers are made through an exchange of paper documents between banks at two clearing sessions per day. For inter-provincial (non-local) interbank payment transactions, in addition to sending paper documents, electronic instructions must also be sent through the national communications network set up by the SBV's Centre for Informatics of the Bank (CIB). In the CIB network, transfers are processed by the provincial SBV branch, which inputs information into the CIB system. The CIB then routes the transfer to the appropriate receiving SBV branch. Settlement accounts are debited and credited accordingly upon receipt of a copy of the transfer document.

For foreign payments, 20 Vietnamese banks have joined S.W.I.F.T. and the system allows their branches to transmit and receive foreign payments via their respective head offices. At present, the number of transactions through this system is over 2,500 per day.

Payment instruments

The range of non-cash instruments is limited at present, and they are mainly paper-based. The most commonly used non-cash payment instruments are authorised payment orders, which account for nearly 70% of all non-cash payment transactions. Recent improvements in the area of cheques include a single format for all types of cheque and the transferable cheque. Payment vouchers were introduced in 1994 and are now accepted as a convenient payment instrument. International credit cards were first issued in Vietnam in 1995 and their use appears to be increasing.

Payment volume

The turnover of all payment transactions made through the banking system in 1997 will be about 1,500,000 billion Vietnamese dong (equivalent to US\$ 120 billion), with about 6 million transactions, of which 60% are carried out through the commercial banks' internal payment systems. Of the interbank payment transactions about 60% are made through the local (provincial) clearing centres.

Cash payments account for over 40% of all payment transactions. Generally, Vietnam's payment system seems to be underdeveloped.

Challenges

Technology

Many bank branches lack the appropriate equipment to serve a modern payment system. The shortage of funds is the main difficulty in modernising the payment system at many banks.

The poor infrastructure of the communications network is another stumbling block for electronic funds transfer. Even though the clearing time has been reduced from seven days to one or two days, the payment transactions from and to remote locations are sometimes delayed.

The payment instruments available and the quality of banking services do not meet the needs of customers for a low-cost, confidential, convenient and reliable payment medium which is essential to a market economy. In addition, because the use of payment instruments is sometimes complicated, many people prefer cash to non-cash instruments when conducting payment transactions.

The current payment system is unable to cope with the anticipated significant increase in the volume of monetary transactions that is characteristic of the development process. Most inter-provincial payments are carried out through a combination of intrabank and local interbank transfers, lengthening the execution time significantly.

The lack of knowledge of the SBV's staff about modern payment mechanisms is another factor hampering the development of the system. Even though the SBV has held many training courses for its staff, the results still do not meet requirements. The low level of SBV salaries compared with the commercial banks is obviously the greatest obstacle to improving the staff's qualifications, since the SBV cannot attract well-trained, experienced and skilled persons. This is the major constraint on the pace of modernisation of the payment system.

In the absence of a national clearing centre, branches of commercial banks have to open accounts with the provincial branches of the SBV. This leads to an inefficient use of funds for all commercial banks, especially given the lack of an effective mechanism for transferring funds rapidly between provinces in the event of a shortfall or surplus. As a result, the cost of the payment system is raised. It is difficult to optimise the use of all payment accounts throughout the country. Commercial banks have to maintain a large amount of money in their payment accounts at the SBV's

provincial branches in addition to their compulsory reserves with the central bank.

The choice of payment instruments is limited and does not meet modern requirements. The constraints of the current payment systems make it difficult to develop new products and to offer new services which could become an important source of fee income for the commercial banking sector.

Legal framework

According to the Decree Law on the State Bank of Vietnam of 1990, the SBV is responsible for organising settlement in the banking system. In addition, Government Decree No. 91/CP of 25th November 1993 establishes a legal framework for the organisation of payments in the banking system.

The other important piece of legislation concerning the payment system is Government Decree No. 30/CP promulgating the regulation on the issuance and use of cheques dated 9th May 1996. This Decree has clarified the obligations of the various parties involved in cheque transactions. In addition, cheques can now be transferred. Many provisions of this Decree are similar to those in cheque laws in other countries.

However, the legal framework has still not been completed and has certain features that may restrict payment transactions through the banking system, namely:

- overdrafts on payment accounts (i.e. current accounts) are not permitted. A customer can only conduct a payment transaction through a bank if he holds sufficient covering funds on his payment account;
- the penalty for abuse in the processing of payments has not been completely defined by regulation, raising the risk in payment transactions through banks.

External constraints

Vietnamese per capita income is still low, standing at only US\$ 300. Vietnam is in the lowest per capita income group in South-East Asia. Thus the cost of transactions through banks is too high for the average level of

income. The demand for holding deposits with banks and making payment transactions through banks is very low.

The Vietnamese people tend to prefer to use cash in payment transactions rather than non-cash instruments. Some people find difficulty in using cheques or other payment instruments when they are required to fill in cheque forms and other documents. Many people are reluctant to make payments through banks.

The level of development of the trading and services system also affects the scope for expanding payment transactions through banks. Most trading transactions between individuals are on a small scale and take place in retail markets, where non-cash instruments such as credit cards or cheques are too costly.

The differences between various types of bank, especially between foreign and domestic banks, in terms of sophistication level, payment equipment and technology lead to differing views on the same rules and regulations. This makes it hard for the regulator to draw up a uniform regulation for all types of bank without giving rise to complaints.

Solutions and orientation

Modernisation of the bank payment system

The modernisation of the bank payment system is the focus of attention in the strategy for developing the banking system. With the aid of a loan of US\$ 49 million from the World Bank, Vietnam's payment system is now undergoing modernisation. Our ultimate objective is to help develop a modern banking sector capable of meeting the needs of a growing economy, thereby increasing confidence in the Vietnamese banking system. The immediate objectives in the coming years are to improve payment services in the economy in order to reduce float, speed up transfers of funds and increase the efficiency of funds transmission, while offering convenience and service to users; and to strengthen the operational capabilities of participating banks in order to stimulate commercial bank initiatives to improve internal management and customer service.

The national interbank payment clearing and settlement system will satisfy the needs of both the SBV and the commercial banks. Under this system the SBV is planning to build a national clearing centre in Hanoi and to set up a clearing centre in the suburbs of Hanoi that will provide local and non-local interbank clearing and settlement services for all payment transactions throughout the country. The interbank payment system will comprise:

- a small-value subsystem for credit transfers and pre-authorised debit transfers, able to handle batch payments as well as individual payments; and
- a large-value subsystem for credit transfers, providing a real-time gross settlement facility for individual time-critical payments.

With the new system, settlement accounts will be centralised, thus facilitating better treasury management and freeing up resources that can be used for productive purposes. The centralised account will also eliminate the fledgling interbank market as banks rationalise their liquidity management.

Commercial banks' intrabank payment systems will be upgraded. The modernisation project also aims to meet the intrabank and international payment needs of the six participating banks. Each participating bank's system will be able to handle all domestic intrabank payments, both within and between provinces. The generalised Commercial Bank Payment Systems architecture is also capable of accommodating the changing needs of the commercial banks as they implement their plans to improve customer accounting.

In the area of international payments, the number of banks which are members of S.W.I.F.T. will be increased. The stand-alone S.W.I.F.T.-based international payment facility introduced at the head offices of the commercial banks will be integrated with their payment systems. The modernisation of payment technology will provide the commercial banks with a special application that will allow them to freely execute out international correspondent payment transactions through S.W.I.F.T.

As part of the modernisation project, the communications network and equipment for payment transactions will be upgraded. The time needed for the execution of a payment transaction through the banking system will be shortened significantly, especially for large-value funds transfers.

Improving the telecommunications network

Improving the telecommunication infrastructure is one of the highest priorities of the SBV. Significant investments are being committed to upgrading physical circuits and installing a modern telecommunication infrastructure backbone. Vietnam is currently in the process of completing an X.25 data communications network.

Developing new payment instruments

The improvement of the payment systems will enable banks to develop new payment instruments. The SBV is drawing up a regulatory framework for the issuance and use of bank cards and the settlement of bank card transactions, creating the necessary conditions for expanding the use of bank cards in Vietnam.

Completing the legal framework

The SBV is playing an important role in the development of a comprehensive legal framework for payment operations. Regulations governing electronic funds transfer systems are currently being formulated. When complete, these regulations will provide a legal and regulatory framework to underpin all aspects of modern electronic payment operations.

The Decree on Cheques will be upgraded to a law. Our objective is to simplify the cheque form and fulfil the regulations on cheque use and issuance in order to make cheques more popular in payment transactions.

The ultimate objectives in building the legal and regulatory framework are to ensure that:

- procedures and regulations for system operations are clearly documented;
- specific rights attaching to existing or newly proposed non-cash payment instruments, in both paper and electronic form, or relating to the way they are handled and settled, are formalised;
- payment system participants, as providers of services and users of instruments, are clear as to their rights, responsibilities and obligations to each other and enjoy protection in the event that fraud or mistakes by other participants result in a financial loss;

- internationally accepted standards, definitions and procedures are adopted to the extent possible.

Staff training

Staff training and development are among the most important factors that will influence the success of the payment system development process. The training plan is focused on three main areas:

- application training will meet the needs of technical staff and end-users (system operators, supervisors and managers) and train them in the use and operation of interbank and intrabank payment system applications;
- technical training will provide the skills required to support the installation, operation and maintenance of the computers and telecommunication equipment and services;
- management training will focus on interpreting and using the information that will be generated by the system.

Conclusion

A well-functioning payment system is necessary for underpinning efficient financial sector development as well as increasing confidence in the banking sector. With the improvements in our payment system, the volume of payment transactions executed through banks is predicted to increase by 30% annually after 1998.

By strengthening the operational capacities of the banks and enabling them to provide a range of new banking products and services to their customers, the future payment system will meet the demands of a fast-growing, market-oriented economy.