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The Legal 500 Country Comparative Guides

Vietnam

PRIVATE EQUITY

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This country-specific Q&A provides an overview of private equity laws and regulations applicable in Vietnam.

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VIETNAM
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1. What proportion of transactions have involved a financial sponsor as a buyer or seller in the jurisdiction over the last 24 months?

Financial sponsors have been becoming more active in Vietnam in recent years. Especially buyout funds and growth PE funds have orchestrated some large deals in a growing number of domestic industries. As the Vietnamese PE market matures and thus becomes more accessible to foreign capital, these trends will likely continue.

Despite those recent trends, the number of financial sponsors in the Vietnamese market is still comparatively limited. The local banking and financial sectors are under strong scrutiny from the State Bank of Vietnam (SBV) and are subject to various restrictions. The direct involvement of local banks in Vietnamese transactions as buyers or sellers is, thus, an exception. Foreign financial sponsors are becoming keener to do deals in Vietnam. Nevertheless, they often fall short of their goals due to legal restrictions on cross-border transactions in some industries and lengthy licensing procedures for establishing foreign ownership through onshore-offshore structures.

PE investors prefer complex and financially engineered investment structures, such as convertible loans or preference shares. Other investors seek to structure their shareholdings via interposed regional or offshore Special Purpose Vehicles (SPVs) to optimise tax and benefit from flexible legal systems. Larger buyout funds may employ multi-layered offshore structures to allow for various levels of debt and inter-creditor subordination.

2. What are the main differences in M&A transaction terms between acquiring a business from a trade seller and financial sponsor backed company in your jurisdiction?

The main difference in M&A transactions when acquiring a target from a trade seller compared to financial sponsor-backed sellers is that these players have different commercial perspectives on the deal. While buying equity from trade sellers or financial sponsor-backed companies follows the same procedure and documentation, the risk allocation of the deal tends to differ in both variants. Buying from a trade seller often allows a broader range of negotiation on the core parts of the underlying documentation (e.g., the Share Purchase Agreement) compared to implementing a similar deal with a PE firm. Because PE firms want to return capital to investors, they are more willing to give a (moderate) discount on allocating risks in the deal to exit on their envisaged terms. Post-closing risks form a specific example for this phenomenon.

Therefore, representations and warranties and the scope of indemnities will be different when acquiring businesses from a trade seller and a financial sponsor-backed company. From a practical perspective, owner-operators or trade sellers tend to have a much more detailed understanding of the risks associated with their businesses. They are thus more familiar with the general issues of their industry and able to assess the impending operative or regulatory risks for their companies. Consequently, they are generally more willing to accept post-closing risks and be tied in by ongoing obligations. The fact that they have no obligation to crystalise carried interest for backing investors provides further liberty to trade sellers. It allows them more leeway in negotiations than PE firms may avail themselves of in similar transactions.

3. On an acquisition of shares, what is the process for effecting the transfer of the shares and are transfer taxes payable?

In Vietnam, the procedure for transferring shares to an offshore entity may include various licensing procedures, including M&A approval. This is tied to legally defined thresholds that impose the involvement of Vietnamese government agencies.

The Ministry of Industry and Trade (MoIT) is the governing authority for issues of merger control. New laws have recently consolidated the Competition Investigation Agency of Vietnam, the Competition Authority of Vietnam, and the Vietnamese Competition Council under the National Competition Committee (NCC). The new NCC will now be solely responsible for monitoring and investigating breaches of competition law and enforcing any related regulatory sanctions.

Vietnam's new Law on Competition (LoC) came into effect on 1 July 2019. It aims to control competition by outlawing restraining agreements, market dominance, economic concentration, and unfair practices. Local and foreign buyers of Vietnamese targets have a potentially restrictive impact on competition in the domestic market. This impact is defined as any kind of influence that is bound to exclude, reduce, or hinder competition in the market.

PE investors need to navigate the new rules on economic concentration when contemplating investment activities. Outcomes are sometimes hard to predict because the new laws are less concise than the previous ones and, since their implementation, provide less precedence. In particular, concrete thresholds for economic concentration have been removed under the new LoC and redefined more vaguely.

Capital gains from the sale of shares are subject to Vietnam's Corporate Income Tax (CIT), set at 20 per cent. The taxable amount is the difference between the proceeds of the sale minus the investment costs and transactional expenses. The Vietnamese seller has a legal duty to withhold the applicable tax amount and to cooperate with Vietnamese tax authorities. However, if buyer and seller are both offshore entities, the local target company is responsible for withholding tax.

Gains earned by a foreign investor from selling securities (i.e. bonds or shares of public Joint-Stock Companies (JSCs), whether listed or non-listed) are subject to CIT at a deemed rate of 0.1 per cent of the gross sales proceeds (replacing the capital gains tax applicable on net gains). Tax treaties may provide some protection from applicable taxes. Utilising an offshore holding company may provide additional opportunities for tax mitigation on exit, depending on the strategy and origin of the investor. However, anti-avoidance rules are applied by the Vietnamese tax authorities with a broad interpretation. Government agencies carry out public scrutiny of company structures and request the disclosure of the fund's origin. As a practical issue, claims made by taxpayers under tax treaties are not reviewed or approved by local tax authorities until a later tax audit. The time-lapse between the tax payment and subsequent reimbursement can, therefore, be quite significant.

A new draft CIT law was released proposing to tax the transfer of capital at two per cent on gross sales proceeds (not dependent on gain/loss position). This would be applied for both direct and indirect share transfers. It further proposed that an internal group restructuring exercise at a no-gain-no-loss position would not be subject to capital assignment tax. However, the legislation is still in draft form and the exact timeline for its discussion and ratification is unconfirmed.

4. How do financial sponsors provide comfort to sellers where the purchasing entity is a special purpose vehicle?

Closing PE deals in Vietnam can be problematic because there is no clearly defined closing mechanism for these transactions. In more developed jurisdictions, the closing of a transaction can be performed in a single day. Buyers can make same-day payments, and shares can be transferred without having to loop the proposed deal through public approval procedures. In Vietnam, however, transfers cannot be carried out only by executing a stock transfer and updating the relevant statutory registers. It is a particularity of Vietnamese law that settlement cannot occur at the same time. This increases the risk of the seller not getting paid and is, therefore, a considerable settlement risk. In particular, investors may be reluctant to fund an acquisition until the target's licenses have been updated to indicate new shareholders (i.e. the buyer).

On the other hand, however, cautious sellers can be reluctant to submit application dossiers to the competent authorities to effect the change of ownership until they have received the (full) consideration. Using escrow arrangements with local banks is one possible solution. However, Vietnamese law and the practical requirements of local financial institutions create additional uncertainties and stretch transaction timelines.

5. How prevalent is the use of locked box pricing mechanisms in your jurisdiction and in what circumstances are these ordinarily seen?

Consideration structures vary from deal to deal. Vietnam regularly witnesses the use of locked box pricing mechanisms. Meanwhile, other common pricing mechanisms are completion accounts and fixed-price structures.

6. What are the typical methods and constructs of how risk is allocated between a buyer and seller?

Vietnamese transaction documents will often allocate the regulatory transactional risk via conditions precedent, subsequent or post-closing undertakings.

7. How prevalent is the use of W&I insurance in your transactions?

The use of Warranty and Indemnity (W&I) insurance is quite common in Vietnam and is gaining traction, especially in larger PE deals. Already, many outgoing PE firms pay W&I insurance premiums that enable them to return funds to Limited Partners (LPs) and crystalise carried interests.

8. How active have financial sponsors been in acquiring publicly listed companies and/or buying infrastructure assets?

The Vietnamese capital markets are now getting more considerable exposure to sizeable international PE deals. Especially in the last two years, Vietnam has witnessed many large PE transactions involving foreign financial sponsors. The targets of these acquisitions have primarily been publicly listed companies. Foreign PE buyers are less likely to invest in existing Vietnaesese infrastructure assets. Infrastructure projects typically take the shape of cooperation between foreign investments and local public companies or state-owned entities. As Vietnam's infrastructure widely falls behind international quality standards and maintenance, foreign financial sponsors tend to refrain from buying existing Vietnamese infrastructure assets.

According to Vietnamese enterprise law, the only form of publicly-traded company is the JSC. A JSC is a commercial enterprise with an assigned charter capital that is divided into equal portions (shares). There can be no fewer than three shareholders. The maximum number of shareholders in a JSC is not limited by law.

Foreign shareholders can be sole owners of a JSC within the confines of restrictions imposed by the governing investment laws. Ownership can also be split between local and foreign investors in a cross-border partnership. A Vietnamese JSC may issue shares and publicly list them on the Vietnamese Stock Exchange, subject to eligibility and fulfilling the conditions for an Initial Public Offering (IPO).

A public company under Vietnamese law qualifies as such if it has a contributed charter capital of at least 30 billion VND (roughly USD 1.3 million) and at least 10 percent of the voting shares are held by at least 100 non-major shareholders, or if it has successfully carried out the registration of an IPO with the competent authority.

There are restrictions on local companies' capital held by foreign investors in certain sensitive sectors, which are listed in Vietnamese investment law. Unfortunately, the law does not give any specific guidance on the acquisition of assets or merger transactions to which a foreign investor is a party.

Vietnam is in the process of creating increasingly favourable conditions for investment into its overall infrastructure by promoting Public-Private Partnerships (PPP) and revising its laws to include foreign bidders in publicly-funded infrastructure projects.

On the back of these developments, international PE investors have recently started to shift their focus to Vietnam. The growing confidence in its market is thanks to Vietnam's economic success, built on a foundation of more than three decades of political stability and almost uninterrupted GDP growth. The domestic PE market hit USD 3 billion in 2018 and USD 1.9 billion in 2019 (excluding real estate and infrastructure) – a multiple of the volumes seen in the preceding five years.

The volume of PE deals reached a record high in 2020. This trend continued into the first three quarters of 2021 with an impressive total of 41 announced deals (equal to the 2020 figures). A quarterly deal value of USD 2.5 billion in Q2 of 2021 marked the second-highest quarterly value on record since the USD 5.2 billion mark struck in Q4 of 2017.

9. Outside of anti-trust and heavily regulated sectors, are there any foreign investment controls or other governmental consents which are typically required to be made by financial sponsors?

From a legal perspective, the starting point for all foreign PE investment into Vietnam is market access. The critical question for market access in Vietnam is whether an investment is prohibited, subject to certain conditions, or unrestricted.

The prohibited and conditional sectors are contained in a list known as the "negative list", in which foreign investors are either completely or conditionally restricted from market entry. This "negative list" forms part of the implementing regulations that define the new Law on Investment (LoI). Commercial activities that are subject to restrictions, which may come in the shape of investment conditions or a complete ban on certain business lines, need to be properly licensed in order to be compliant. Business sectors not on this list are open to foreign investment. Foreign investors are guaranteed equal treatment in matters relating to market entry, licensing, and tax. In some cases a foreign PE investor may, therefore, be compelled to co-invest with a local company because the investment sector is restricted. Usually, PE investors will attempt to secure the largest stake possible and sometimes try to use loopholes in the LoI to structure these restrictions.

Vietnamese regulators have developed faster and more predictable licensing procedures over recent years. However, the process of closing a transaction in Vietnam can still be a time-consuming exercise for all involved parties. Though updated procedural rules offer more certainty and require less time, legislators still need to improve timelines and workstreams between different government agencies. Meanwhile, most investments continue to include complex registration with competent authorities. Most of these licensing procedures are governed by the Ministry of Planning and Investment (MPI) and its regional sub-departments (DPIs).

Transactional steps that are particular to Vietnamese investment law add complexity to standard deal documentation, such as term sheets, due diligence, disclosure, etc. The licensing process also adds additional time, costs, and uncertainty to these PE deals. As a consequence, transaction fees (as a percentage of deal size) can be higher than in other jurisdictions.

Despite the continued improvement of the regulatory framework for PE transactions (e.g., the new LoI), Vietnam still requires onerous licensing procedures and public approval for investment into specific business lines. However, free trade agreements with neighbouring countries have impacted the regulatory thresholds for foreign investment into certain local industries and enabled investors to acquire majority shares in previously restricted or conditional business lines. As there are still only a few PE companies active in Vietnam, some industries see a lingering undersupply of capital.

Foreign investors wanting to acquire a Vietnamese target will usually have to obtain an Investment Registration Certificate (IRC) before being permitted to bring the money allocated to purchase the target into Vietnam. Public licensing procedures are renowned for adding several months to project and transaction timelines, which can be regarded as the cost of doing business in Vietnam.

Additionally, exit strategies still inhibit investing in Vietnam, as many investments do not guarantee short-term profitability and the repatriation of funds and gains may create regulatory difficulties.

10. How is the risk of merger clearance normally dealt with where a financial sponsor is the acquirer?

As indicated above, the LoC introduces the obligation for investors to report economic concentrations to the NCC. Such economic concentration is subject to thresholds that provide only vaguely defined factors:

- the companies' totals assets and turnover in the domestic market;
- the single transaction value; and
- the companies' combined market share.

The NCC has a high degree of discretion when deciding on individual PE transactions on a case-by-case basis. This adds another layer of uncertainty to these deals.

Risk allocation is, therefore, vital for the planning and successful implementation of PE deals in Vietnam. The authoritative clearance risk is usually allocated to the buyer. As a result, PE investors need to commit additional resources to preliminary transaction due diligence and consider these risks when choosing their Vietnamese target.

11. Have you seen an increase in the number of minority investments undertaken by financial sponsors and are they typically structured as equity investments with certain minority protections or as debt-like investments with rights to participate in the equity upside?

Investors predominantly use direct minority investments and convertible loans to enter the domestic PE market. In both cases, minority protection and reserved matters are built into the transaction documentation to distribute the associated risks amongst the parties.

The most common deals in Vietnam are minority investments, which often fall below the USD 20 million threshold. They are predominantly growth capital-driven deals and funded by unleveraged equity. The reason for this is that onshore acquisition finance is unavailable. Smaller offshore PE funds are also rarely in a position to leverage their balance sheets to raise cheaper offshore debt. Larger buyout funds tend to leverage their equity through multiple layers of structurally subordinated debt for deals above USD 100 million. Vietnamese PE transactions may take the shape of either primary or secondary sales. Many investors also choose to obtain a minority position, while securing an option to acquire more shares later, subject to pre-agreed valuations.

The interests of minority shareholders are protected by contractually agreed reserved matters (negotiated on a case-by-case basis and usually contained in shareholders' agreements) and statutory provisions concerning the protection of minority rights.

Vietnamese enterprise law does not define any squeeze-out rights for majority shareholders, which would enable them to take control of all shares in a company against the will of minority shareholders. Contrary to the absence of such squeeze-out rights, the buyer has a statutory duty to purchase remaining shares in the target under certain conditions.

For instance, if a bidder acquires more than 80 percent of the target's total shares, they will also be obliged to buy all remaining shares (of the same type) from other shareholders. The shareholders may request that this sale be executed at the bid's price within 30 days of the offer.

Investors are mostly opting for growth equity, followed by venture capital and buyouts. This strong demand for growth can be attributed to a large number of fast-growing domestic companies with a need for capital to feed their expansion plans.

12. How are management incentive schemes typically structured?

Management equity is ubiquitous in PE and Vietnam is no exception. Vietnamese law allows for Employee Stock Ownership Plan (ESOP), while not explicitly regulating them. These structures serve to incentivise key management and align them with the exit timeline of the PE investors. Moreover, PE investors also attempt to lock in crucial management and incentivise them to stay with the company after their exit. This can be encouraged by requiring the management team to roll over a certain percentage of the proceeds from their ESOP shares into new ESOP shares.

Therefore, while the form of management participation depends on the deal, in most cases ESOPs are the chosen path of equity incentives. Management shares are issued to a selected circle of key management in order to let them participate in the anticipated company success.

13. Are there any specific tax rules which commonly feature in the structuring of management's incentive schemes?

Because offshore ESOPs are the most widely used management incentive scheme in Vietnam, they often raise specific tax questions, depending on the concerned offshore jurisdiction. Offshore ESOPs are programmes that award shares issued in overseas companies to domestic employees of a foreign commercial presence in Vietnam. An ESOP can be structured through either an award of free shares or an offer to sell shares on preferential terms to the employees. Although these structures are not uncommon, Vietnam has no specific rules on offshore ESOPs. This means that Vietnamese legal standards and CIT regulations do not provide explicit guidance on offshore ESOPS.

Vietnamese law sets out certain rules for controlling a resident's indirect investment overseas in terms of an outbound investment portfolio. In the absence of specific directions, Vietnamese residents working in multinational companies may participate in offshore ESOPs under certain conditions. Any (foreign) organisation that wants to issue an ESOP must have a commercial presence in Vietnam and directly employ the selected employees in Vietnam. The definition of "commercial presence" includes any subsidiary, affiliate, branch, representative office, and project office.

Under Vietnamese personal income tax (PIT) regulations, the transfer of securities (including shares and the right to purchase shares) is taxed at 0.1% PIT of the transfer price. This applies regardless of the transferor's tax residency in Vietnam. Bonuses received in-kind under an ESOP (i.e. shares or stock options) are also subject to PIT.

In Vietnam, PIT is calculated at a progressive rate. The top tax bracket for PIT is 35% for tax residents and a flat rate of 20% on their total income for non-residents. When transferring bonus shares, the respective employees are subject to PIT on the transfer of securities. The applicable rate is also 0.1% of the transfer price. The relevant time for PIT taxation is the time of exercising the stock options or transferring the shares to a buyer.

Because owning foreign shares is a restricted activity for

Vietnamese citizens, Vietnamese law requires the registration of ESOPs with (SBV). This validates the Vietnamese employees' right to own foreign shares and legally remit funds overseas to exercise a purchase option. The local employer must file this registration with SBV and is subject to regular reporting requirements.

14. Are senior managers subject to non-competes and if so what is the general duration?

When companies want to restrict the right of a manager or employee to compete after leaving the company, they may consider imposing a non-competition clause.

The permissibility and enforceability of such restrictive provisions under Vietnamese law have not been finally resolved under Vietnamese jurisdiction. Practitioners have to deal with the lack of accountability this brings forth when introducing non-competition clauses into their management contracts. In terms of enforceability, Vietnamese courts will often be unable to judge in accordance with conventional international standards. Vietnamese law does not provide an intricate and well-balanced system of considerations to make when crafting or interpreting the true meaning and enforceability of a non-compete or non-solicitation clause.

From a practical perspective, the validity of non-competes depends on the individual's level of compensation in light of the restriction to their labour. Another essential aspect is the term of the clause. As a general rule, the shorter the duration of the non-compete clause, the more likely it is to be enforced by a competent Vietnamese court.

Non-compete and non-solicitation clauses are not uncommon in Vietnamese drafting. However, there is currently no certainty on their enforceability or legality. Interpretation depends on the specific litigation of such clauses and is subject to the reading of Vietnamese labour courts, which generally tend to rule in favour of the employee and against the solicited competitive restriction.

15. How does a financial sponsor typically ensure it has control over material business decisions made by the portfolio company and what are the typical documents used to regulate the governance of the portfolio company?

Buyers of Vietnamese PE targets are well-advised to intervene and proactively steer their target's operations. This can also consist of supporting the management with their day-to-day business activities. Experts in Vietnamese PE deals will seek as much control over the target's management decisions as possible. This control can be documented by way of reserved matters, information rights, corporate governance, board seats, and management oversight.

Most PE investment into Vietnam is defined by solid control and collaboration with the local target's management.

Though local companies can gain from the contributions of professional investors, working with inexperienced managers or local teams can be trying. Nevertheless, it is vital to keep a close grip on the target's affairs post-closing and regularly run compliance and management screenings to stay on top of operational issues.

Because corporate governance and management in Vietnam continue to lag behind international standards, this can create both challenges and opportunities. Formerly state-owned companies that have preserved bad habits from pre-equitisation times might have some lingering issues that require PE buyers' specific attention. For instance, it is not uncommon for managers in some industries to accept kickbacks or underhanded commissions from business partners. PE investors should also be wary of issues concerning workforce and mid-level management staffing decisions, as favourable treatment is often given to family members or others with personal connections. While private companies might be less susceptible to such habits, a pivotal drawback of many Vietnamese companies remains their chronic lack of investment in their workforce and management. Steep hierarchies inside most Vietnamese businesses reduce personal accountability at the lower management levels. Meanwhile, considerations that are prevalent in modern enterprises in more developed markets, such as preserving resources and pursuing sustainable business solutions, are the exception rather than the rule.

16. Is it common to use management pooling vehicles where there are a large number of employee shareholders?

In addition to rollover equity, a fund will often set aside a pool for existing or new management.

This is a form of incentive equity, the shape of which depends on the structure of the target and the PE investor's preference. They can include profit interests, options, phantom equity, restricted stock grants, and other forms of equity. The core consideration to make under Vietnamese law is how these tools are treated by the tax authorities and how to receive dividends from these shares.

Incentive equity grants are often subject to vesting and performance thresholds. They are also usually subject to repurchase rights contingent on the individual labour contract's termination.

17. What are the most commonly used debt finance capital structures across small, medium and large financings?

Vietnam's PE landscape is witnessing the implementation of an increasingly broad range of debt finance capital structures. The chosen shape heavily depends on the type and volume of the proposed deal. While smaller capital financing (e.g. Venture Capital) tends to build on convertible notes and safe notes, larger-scale transactions may require more sophisticated structures.

If the envisaged transaction has an offshore element, financing may occur offshore and be supplemented by a local Shareholders' Agreement (SHA) that helps to optimise tax implications. Another fact reflecting on these considerations is that Vietnam has no thin capitalisation rules.

18. Is financial assistance legislation applicable to debt financing arrangements? If so, how is that normally dealt with?

As in many emerging markets, the Vietnamese legal system often lacks the standards and comprehensiveness known from more mature jurisdictions. As one example of this, Vietnamese law is not familiar with the concept of financial assistance to debt financing.

19. For a typical financing, is there a standard form of credit agreement used which is then negotiated and typically how material is the level of negotiation?

Vietnam does not have a standard form of credit agreement but limits the permissible terms across several laws. Foreign investors need to address registration requirements and the particular scrutiny of SBV. While the requirements of a deal's financing arrangements vary from transaction to transaction, they are usually heavily negotiated.

20. What have been the key areas of negotiation between borrowers and lenders in the last two years?

The key areas of negotiation between borrowers and lenders usually focus on deal pricing and security.

21. Have you seen an increase or use of private equity credit funds as sources of debt capital?

Domestic activity remained dominant in 2021, following an active 2020. A total of 20 deals were announced in Q1-Q3, just three deals behind 2020's record annual total. This level of activity demonstrates the growing confidence among local enterprises as they look to mature and scale-up operations in an international context.

Vietnam has witnessed a substantial influx of foreign capital into various domestic industries. Together, this has amounted to record figures in the PE market. Driven by a suitable environment for fast-growing startups with low labour costs and a young, tech-savvy, and well-educated population, high returns await Venture Capital (VC) disbursed by PE funds and other institutional investors. A diverse landscape is developing around young companies with attractive products or business models, especially in tech and e-commerce. We see this trend accelerating, as Vietnamese entrepreneurs are becoming more familiar with the benefits of working with professional investors.

Vietnam's position at the intersection between the global need for a green energy revolution and its desire to reach energy independence from its neighbours and refurbish its grid has birthed new government policies. This macro-trend translates into legal amendments that are beginning to allow foreign investment in formerly restricted industries. Renewable energies have, consequently, seen an unprecedented surge over the last two years, with local generation capacities multiplying over a relatively short time.

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