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LEGAL

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LEGAL UPDATE

REQUIREMENTS FOR OFFSHORE LOANS WITHOUT GOVERNMENT GUARANTEE

Earlier this year, the State Bank of Vietnam (**SBV**) released a draft circular (**Draft Circular**) replacing circular No. 12/2014/TT-NHNN (**Circular 12**) on conditions for non-government guaranteed cross-border foreign loans for public feedback. The Draft Circular proposes to tighten the management of non-government guaranteed offshore loans to control Vietnam's overall borrowing exposure. It is unclear when the Draft Law will be approved and promulgated by the competent authorities.

In this update, we set out some notable points of the Draft Circular.

1. Cap on Borrowing Costs

Under Circular 12, the SBV Governor may determine a cap on borrowing costs of offshore loans for each interest period. However, to date, the SBV Governor has not made use of this opportunity. The Draft Circular proposes a specific cap on borrowing costs of a foreign loan as below:

- For offshore loans denominated in a foreign currency, the cap will be:
  - Reference interest rate + 8% per annum in case of offshore loans with reference interest rate; or
  - SOFR[1] Term Rate + 8% per annum in case of offshore loans without reference interest rate
- For offshore loans denominated in Vietnamese Dong: the Vietnamese Government bond interest rate[2] + 8% per annum.

2. Foreign Exchange Hedging Transactions

The Draft Law adds a new clause under which Vietnamese borrowers of offshore loans are required to hedge their borrowings. This new policy aims to:

- Mitigate the potential damage for borrowers in case of any fluctuation in the foreign exchange rate and limit the negative effect on the SBV's exchange rate's management; and
- Secure the foreign currency market if the demand for selling and purchasing of foreign currency suddenly increases when borrowers draw down or repay offshore loans.

Borrowers need to hedge the foreign exchange when the following criteria apply:

- For *short-term* offshore loans with a principal of more than USD 500,000:
  - The hedging value must be equal to at least 30% of the actual disbursement amount; and
  - The hedging transaction must be conducted before or on each disbursement date.
- For a *medium-or long-term* offshore loan for any repayment instalment of a medium-or long-term loan that exceeds USD 500,000:
  - The hedging value must be equal to at least 30% of each instalment repayment; and
  - The hedging transaction must be conducted at least three months before each repayment date.

There are some exceptions and these requirements do not apply to borrowers:

- That are credit institutions or foreign bank branches licensed to provide foreign exchange services; and
- Who expect to have sufficient revenue in foreign currencies to pay the foreign loan. However, the Draft Circular does not provide any further guidance on how to prove sufficient revenue.

Important is that the Draft Circular is expected to have a retroactive effect because foreign loans executed before the effective date of the Draft Circular are also required to hedging of foreign exchange when it is:

- A short-term offshore loan with the principal of more than USD 500,000 or in any other foreign currency of equivalent value that has not been fully drawn down; or
- A medium-term or long-term offshore loan that has not been fully repaid.

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[1] SOFR = Secured Overnight Financing Rate.

[2] The interest rate of the Vietnamese Government bonds is the latest implemented interest rate of 10-year government bonds in Vietnamese Dong as determined prior to the signing date of the loan agreement and its relevant amendments/supplements.

3. Appointment of Vietnamese Security Agent

Another new requirement imposed on offshore loans by the Draft Circular is the obligation to appoint a Vietnamese security agent. Parties to offshore loans shall need to engage a security agent if such foreign loans are secured by assets in Vietnam. The security agent can be a credit institution, a foreign bank branch or any other entity established and operating under the laws of Vietnam. This requirement shall not apply if the secured party and the securing party have agreed that the secured party will assume secured assets to replace the performance and fulfilment of secured obligations.

4. Particular conditions for Borrowers not being Credit Institutions and Foreign Bank Branches

Borrowers that are not credit-institutions and foreign bank branches may use short-term and medium or long-term foreign loans for the following purposes:

- *Short-term loans* that are used to repay short-term debts within twelve months from the signing date of the loan agreement.

  Under the Draft Circular, the scope of short-term debts is determined according to the current regulations on the corporate accounting regime but excludes debts arising from:
  - Loan agreements with residents; and
  - Payables arising from purchases of securities, capital contributions, shares, investment real estate and project transfer.
- *Medium* or *long-term loans* used for:
  - Implementation of the borrower's investment projects;
  - Increase of capital for production and business activities of the borrower; and
  - Restructuring of existing foreign loans of the borrower.

Furthermore, under the Draft Circular, the offshore loans shall be used to carry out the production and business activities within the registered scope and will be subject to certain limitations, such as lending cost, loan limits, and prudential ratio.

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