INVESTMENT POLICY FOR LOCAL DEVELOPMENT
INVESTMENT FUNDS IN VIETNAM

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Final Report

Operating guidelines and procedures

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1. **INTRODUCTION**

These draft operating guidelines and procedures are submitted as part of our work on establishing a unified investment policy for the Vietnam’s Local Development Investment Funds (LDIFs). The operating guidelines set out the various stages of project/investment appraisal, portfolio management/monitoring procedures and the high-level staffing guidelines for investment appraisal and portfolio management.

Where the report recommends numerical thresholds/suggestions – these are indicative best estimates based on international experience. The intention is for the LDIFs to move towards these good practices and benchmarks, as they grow in size, develop a larger performing portfolio, and become mature Funds. It is recognised that the implementation of these policies are subject to the legal and regulatory framework provided by the MoF – to that extent, the recommended policies seek to inform the development of MoF draft laws/decrees for the LDIFs. Also, it is recognised that some of the LDIFs may need to further develop their skills and capacities to implement the recommended policies and guidelines – in that regard, these policies may guide any technical assistance intervention that the Funds may receive in the future.

2. **PROJECT PIPELINE**

2.1. **Outreach/Business development**

The LDIFs will need to allocate resources to identify and support the development of projects that have the potential to meet the Funds’ eligible criteria. The business development activities may include but not be limited to: holding public workshops to provide information about the types of investment products, eligibility criteria, and the application and credit approval processes; meeting with government officials, private sector developers, and others to learn about potential projects; and disseminating information to prospective applicants about LDIF credit and investment requirements and policies in meetings.

The LDIFs should consider appointing one senior individual within their organisation to be responsible for business development and marketing activities (“Business Development Officer”). Additional support staff may be assigned depending on resource availability and planning targets.

In advance of each year, the Business Development Officer should work with other departments to identify particular priority areas and establish overall level of activity based on the number of transactions targeted in the budget for the upcoming year. The Business Development Officer shall submit any prospective investment opportunity along with the available documentation to the New Business Committee for its initial screening and approval.
2.2. Project identification

Once projects have been identified, LDIFs should encourage sponsors to discuss their projects and financing requirements. Multiple meetings with the same sponsor group may be appropriate as the project progresses through the development cycle. Such meetings provide the LDIFs with the opportunity to informally “guide” the development of the project to increase the likelihood that it will satisfy the Funds’ credit or investment requirements.

The LDIFs should provide the sponsor with an “application checklist” of information required to commence the formal appraisal process. The Stage 1 appraisal process should commence when substantially all of the information requested on the checklist is available.

3. Project/Investment Appraisal

3.1. Stage 1 – Initial review

The purpose of the Stage 1 review is to provide an in-depth review of the application materials over an up to 45-day period to determine: (1) whether the project should proceed to Stage 2; (2) aspects of the project that require further development prior to commencement of Stage 2; or (3) rejection of the application because of a “fatal flaw” or policy grounds.

The scope of the review should address the eligibility criteria and assessment outlined in the Investment Policy and Guidelines with particular emphasis on the following:

- Sponsors’ level of commitment, including technical and financial resources necessary to develop, finance, construct and operate the project for a sufficient period of time to fully repay the LDIF loan or provide the target investment return for an LDIF equity investment.

- Sponsors’ understanding of and ability and willingness to comply with applicable government laws and regulations.

- Strength of the project’s commercial and contractual structure.

- Financial strength of the project’s primary contractual/commercial counterparties in relation to their obligations to the project.

- Reasonableness of the project’s financing plan, base case financial projections and ability of the project’s economics to withstand reasonable “worst-case” sensitivity cases.

- Identifying any technology risk, construction and operating risks.

The findings of the Stage 1 review should be presented in a detailed memorandum or report that includes an executive summary of the significant findings and a recommendation on further action.
Once the Investment Committee makes a decision on the application, a Stage 1 Appraisal letter will be sent to the applicant with notification of the action taken, and include a list of areas that require further attention prior to commencement of Stage 2 as applicable.

The Stage 1 review period should not exceed 45 calendar days from the time the application is submitted, until the Stage 1 Appraisal letter is sent to the applicant.

It is not expected that the Stage 1 appraisal will require the resources of outside technical, market or legal advisors. To the extent that in exceptional cases, the services of an outside advisor are required to adequately conduct the Stage 1 appraisal, wherever possible, the cost of retaining the outside advisor shall be charged to the applicant. Selection of the outside advisor should be conducted through a bidding process to ensure transparency and provide assurance to the applicant that the cost for these services is established through a competitive procurement process.

3.2. **Stage 2 – Detailed appraisal and commitment**

The purpose of the Stage 2 review is to conduct a comprehensive review of all aspects of the project and conclude with the Investment Committee’s approval of the transaction and negotiation and execution of a term sheet or similar document.

The scope of the review should address the areas identified in the Investment Policy and Guidelines and provide for a provisional risk rating that will be confirmed at Financial Close. The Stage 2 appraisal will include: a detailed analysis of the project agreements; technology and construction and completion risk; operating risk; market risk issues; sponsor capabilities and financial strength; counterparty credit strength; cash flow, financial strength, and financial structure of the project; legal issues; and lender security arrangements.

The LDIFs may require that the sponsor revise certain arrangements or project agreement terms, modify the transaction financial structure, post additional collateral, or take such other actions as deemed necessary to ensure that the transaction meets the LDIFs’ credit or investment requirements.

Once all material elements of the transaction are determined to be satisfactory or there is agreement between the sponsors and LDIFs that specified changes will be implemented, a financing term sheet should be negotiated and agreed with the sponsors addressing:

- the terms under which the equity investment or debt financing will be provided;
- a list of the significant project agreements that will be executed as a condition to Financial Close;
- a list of the financing documents that will be executed as a condition to Financial Close;
- a summary of the financing plan identifying the uses and sources of funding;
• a summary of the key elements of the financial structure addressing the timing of debt and equity investments, debt repayment schedule (as applicable), use of proceeds, ownership transfer restrictions, dividend distribution covenants, affirmative and negative covenants;
• events of default, lender collateral security; conditions precedent to Financial Close; and
• other customary terms.

The specific elements of the financing term sheet will depend on whether the LDIF is considering an equity investment or loan. Upon conclusion of the term sheet negotiation, an investment memorandum will be prepared accompanied by the financing term sheet and other appropriate documentation. This package shall be submitted to the Investment Committee for approval. The financing term sheet will be signed with the sponsor after the Committee approval.

The time frame for Stage 2 may typically take between three and six months although more complex transactions may take longer and simpler transactions may take lesser time.

During the Stage 2 process, it may be necessary for the LDIFs to use outside technical, market, and legal counsel to assist in certain aspects of the due diligence process. As under Stage 1, wherever feasible, the cost of retaining the outside advisor shall be charged to the applicant. Selection of the outside advisor should be conducted through a bidding process to ensure transparency and provide assurance to the applicant that the cost for these services is established through a competitive procurement process.

3.3. Stage 3 – Financial close

The principal activities under Stage 3 involve the finalization and execution of the project agreements, financing agreements, collateral security arrangements, permits, and the satisfaction of conditions precedent identified during Stage 2 or afterward.

The provisional risk rating for the transaction should be confirmed or revised shortly after Financial Close. This risk rating will be used to establish the capital reserve amount for the transaction at origination.

As under Stages 1 and 2, wherever possible, the cost for retaining outside advisors should be charged to the applicant.
4. **PORTFOLIO MONITORING/ TRACKING**

Portfolio operations refer to all of the asset management activities that commence following Financial Close for a transaction, and include: asset monitoring, capital allocations, reporting, remediation, and provisioning and write-offs.

4.1. **Monitoring**

Monitoring activities include conducting periodic reviews of the projects; responding to customary borrowing requests for loan disbursements, waivers and approvals, performing valuations of equity investments, and updating the asset risk rating.

4.1.1. **Asset review**

Projects should be reviewed on a quarterly basis based on new information made available since the immediately preceding quarterly review. A short form report should be prepared summarising the findings of the review and highlighting any areas of concern that may require further monitoring. Material notices should be reviewed when received and appropriate action taken depending on the nature of the notice.

Projects that are experiencing significant problems or whose performance is projected to deteriorate significantly compared to the base case projects should be referred to distress asset management for further monitoring and possible action.

The risk rating of the projects in operation should be updated annually based on a detailed review which may include on-site visits as appropriate. Risk ratings may need to be conducted on a semi-annual basis for projects in construction at the discretion of the Asset Risk Management Committee. A memorandum summarising the findings of the detailed analysis and recommended risk rating should be prepared and submitted to this Committee for approval.

4.1.2. **Borrower requests**

Borrower requests to waive covenants or approve certain actions not otherwise permitted on the transaction documentation should be considered under the framework agreed with the other senior lenders to the transaction as documented in the inter-creditor or similar agreement.

Routine or non-material requests should be approved by the senior management of the Fund. Significant requests that could materially or adversely impact the transaction risk profile, such as changes in ownership, material changes in offtake or supply agreements, expansions, or actions that have the potential to materially adversely affect the environment, should be reviewed and approved by the Asset Risk Management Committee.
Disbursement requests should be managed in accordance with existing LDIF policies and practices.

4.1.3. Valuations

Valuations of LDIF equity investments should be conducted at least annually. Valuations also should also be conducted prior to the sale of an equity interest in a project.

Valuations shall be conducted by a recognised and qualified third-party organisation not legally affiliated to the project, its shareholders or other significant project participants (e.g., offtaker). Valuations should be conducted in accordance with international best practices and applicable accounting standards in the Vietnam context.

The LDIFs should procure these services on a competitive basis and require bidders to disclose any existing or prior client relationship with the significant project participants (e.g., shareholders, suppliers and offtakers).

4.2. Capital adequacy adjustment

The risk rating for the transaction at Financial Close should be used to determine the amount of LDIF capital to reserve against potential losses for debt investments, in accordance with the procedures provided in the Financial Policies manual.

4.3. Asset reporting

Short form reports should be prepared for all assets on a quarterly basis within 30 days after the end of each quarter.

An annual report reflecting project performance and financial statements should be prepared within 60 days of the end of the project’s fiscal year.

A risk rating report for each asset should be prepared annually within 60 days of the end of the project’s fiscal year.

4.4. Portfolio reporting

Quarterly and annual reports summarising overall portfolio performance should address among other items:

- portfolio income,
- capital allocation against the portfolio (“capital allocation”),
- risk rating of each asset and the overall portfolio (on a weighted-average basis),
- return on allocated capital,
- number of loans in default and number of loans in payment default,
• number of non-performing loans (i.e., loans which are overdue more than 90 days), and non-performing loans as a percent of the total outstanding debt portfolio,
• number (and percentage of the portfolio) of loans being restructured,
• number and amount of loan provisions,
• number and amount of write-offs for both debt and equity investments,
• valuation of each equity investment, and the
• total return of all equity investments.

The quarterly portfolio report should be prepared within 30 days after the end of each quarter. The annual portfolio report should be prepared within 60 days of the end of the each fiscal year.

4.5. Remediation

Remediation activities may include minor rescheduling of a scheduled debt service payment; project restructuring, involving changes to the project’s commercial and financial structure, including a significant debt restructuring; and liquidation.

• Minor rescheduling may involve the rescheduling of one or two principal payments to one or more subsequent scheduled repayment dates. Minor reschedulings may be triggered by limited force majeure events with no permanent impairment to the project’s assets or counterparties, legal events such as a temporary lapse in a permit leading to suspension of operations, or other such similar events.

• Project restructurings may be required due to material changes to the project’s commercial structure or force majeure events causing significant damage to project assets that compromise the ability of the project to cover its variable and fixed costs including debt service. Restructurings may require the allocation of significant staff time to performing commercial and financial analysis, attend creditor meetings, negotiate new financing terms, and monitor the performance of outside advisors, among other activities.

• LDIFs should pursue restructuring activities in a manner that maximizes the ultimate recovery. While most projects with significant problems may be successfully restructured, in rare cases, the lenders may be required to liquidate the project’s assets in order to achieve the maximum recovery. Asset liquidation should be carried out in accordance with the agreed collateral security arrangements and applicable law.

4.6. Provisioning and write offs

Provisioning for credit risk is required to cover potential loss due to the project’s failure to fulfil its contractual terms to the LDIFs. LDIFs should make provisions for their loan
portfolios in accordance with the Regulation on classification of loans, making and utilizing provision to cover credit risk in banking activities of credit institutions – promulgated in conjunction with Decision 493/2005/QD-NHNN5, dated 22 April 2005 of the Governor of the State Bank of Vietnam. Accounting for provisioning should be performed in accordance with the applicable accounting standards.

Write-offs on loans may be required following a project restructuring or liquidation that results in a loss in loan principal and accrued (but unpaid) interest. Write-offs should be determined in accordance with the applicable accounting standards.

5. STAFFING GUIDELINES FOR INVESTMENT APPRAISAL AND PORTFOLIO MANAGEMENT

The various Boards and Committees and the investment activities/ functions have been outlined in the Financial Policies. This section sets out, at a high level, the organisational and staffing guidelines for the investment appraisal and portfolio management functions.

5.1. Key roles and responsibilities

This section sets out key roles and responsibilities involved in project appraisal, financing, and portfolio operations and risk management.

Project appraisal

- Based on the appraisal stages 1-3 outlined, conducting detailed evaluation and appraisal of investment opportunities (debt and equity) recommended by the New Business Committee. This includes financial, economic, social and environmental eligibility of the investment opportunity, and the investee/ sponsor characteristics. The Department may draw upon external specialists, as required; for instance, for detailed environmental or social safeguards assessment.

- Assigning the risk rating of the investment at origination, to be finalised at financial close. This shall be based on detailed Stage 2 appraisal in line with the criteria and guidelines set out in the Investment Policy.

- Preparing the documentation required at each stage of the appraisal for review and approval by the Investment Committee. Where required, undertaking further due diligence or supplementary analysis and preparing additional documents requested by the Committee.

Financing

- Once a project has been appraised to be eligible and investment worthy, structuring the terms and conditions of the investment (equity financing or loan), including its pricing. In the case of a loan, structuring collateral, guarantees etc.
• Conducting detailed discussions and negotiations with the project sponsor(s) and/or the management team to understand the various risks involved and the financing requirements.

• Preparing the documentation required for review and approval by the Investment Committee. Where required, undertaking further negotiations, supplementary analysis and preparing additional documents requested by the Committee.

• Preparing the financing term sheet once final agreement has been reached.

Portfolio operations and risk management

• Monitoring the performance of the investment, and supervising the overall progress and management of the project. In the case of debt financing, assuming responsibility for collections including following up with the borrower in case of late payments.

• Assessing the levels of risk exposure of each investment and the portfolio as a whole. As set out in the Risk Rating Matrix in the Investment Policy, this involves periodically checking and updating the risk rating for each investment. The risk assessment covers various areas of risk such as market risk, technology, construction and completion risk, operating risk and credit risk, among others.

• Monitoring the key risk management financial ratios to ensure that the specified thresholds are not breached.

• Executing risk mitigation and diversification strategies, to maintain a healthy diversified investment portfolio.

• Monitoring and controlling any credit risk arising from the LDIF’s treasury activities. This risk may be limited by restricting the Fund’s authorised investments to conservative investment eligibility criteria as outlined in the Financial Policies; for example, deposits with banks of a minimum credit rating.

• Preparing the documentation and periodic reports required for review by the Asset Risk Management Committee.

• Adjusting the level of capital reserves allocated based on the risk review.

• Where relevant, implementing portfolio remediation measures to minimise loss for project investments.

• In cases of distress and the need to restructure or reorganise any investment, on receiving direction from the Asset Risk Management Committee, some members of this department may be dedicated to distress asset management, remediation and recovery, to the extent possible.
5.2. **Skills and qualifications**

The skills and qualifications required for these investment activities shall include, but not be limited to:

- Masters degree in finance or accounting, or an MBA and/or a professional qualification in finance or accounting.

- Demonstrable fund management, investment or project finance experience, developed over at least five years.

- Strong knowledge of infrastructure development, financing and associated risks.

- Good understanding of equity and/or debt investments.

- Strong analytical skills, including the ability to understand, develop and utilise financial models.

- Strong written and verbal communication skills.

- Experience in preparing and presenting narratives financial reports, correspondence, and other documents.

- Extensive contract negotiation skills.

- Experience working with public officials, public/private agencies, and sponsors on a range of issues.

- Proven ability to work both independently and in overseeing teams.