REPORT

A REVIEW OF ARTICLES 63 - 73 OF THE COMMERCIAL LAW AND OF APPLICABLE REGULATIONS IN VIET NAM AND A DISCUSSION OF THE REGULATION AND FUNCTIONING OF COMMODITY EXCHANGES IN SELECTED COUNTRIES

ACTIVITY CODE: ICB-15

"Revision of the Commercial Law of Viet Nam"

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I. Main Outputs required by Terms of Reference

1. Relevant outputs according to the ToR, paragraph 4

a) Report/research on the regulations of commodity exchange in Viet Nam, focused in particular on i) the mechanism to settling disputes through the commodity exchange, ii) the type of transactions which can be carried out through the commodity exchange. The research will provide the best international practices of the above mentioned topics (including organization and management of exchange commodities in foreign countries). Recommendations on how to reform the system in Viet Nam will also be provided

b) A report on the present legislation in Viet Nam on commodity exchange. The report will provide an overview of the best practices in selected countries (e.g. Canada, Thailand, Singapore, and India). The report will also illustrate the present situation of commodity exchange members in Viet Nam, the analysis of the conditions to become member of a commodity exchange and a comparative analysis with the legislation of selected countries.

2. Tasks of PMU expert 5 (in cooperation with PMU expert 6 and DMI expert 2)

a) Review the legal system governing transactions through commodity exchange in Viet Nam. In particular the expert shall analyses the following topics:
- Current regulation in Viet Nam, assessment of conformity with the practice;
- Analysis of the basic content of the laws of some countries regulate on transaction through commodity exchange (Canada, Singapore, Thailand, India)
  Compare regulation with some countries.

b) Ccomparative analysis of the statistics in Viet Nam regarding transactions through commodity exchanges compared to selected other countries

3. Tasks of PMU expert 6 (in cooperation with PMU expert 5 and DMI expert 2)

Research focused on identifying the different type of members of commodity exchange, membership conditions, the tasks and obligations of Viet Nam members of commodity exchange and best practices of selected foreign commodity exchange. In particular the analysis shall be focused on the commodity exchange in Viet Nam and in Malaysia, Thailand, India, the UK and the USA.

4. The task of DMI expert 2 according to the ToR, para 4

Report/research on the regulation of commodity exchange in Viet Nam, focused on the following topics:

a) Dispute resolution mechanism on transaction through commodity exchange
- Responsibilities of the ccommodity exchange on dispute resolution
- Different types of dispute that may arise on transaction through commodity exchange;
- Presence and features of dispute settlement body;
- The role and the responsibility of the commodity exchange in settling disputes

b) Main subjects involved and main regulations of foreign commodity exchange, with a particular focus on

- The function of foreign commodity exchange for Vietnamese subjects
- Will a foreign commodity exchange in Viet Nam useful?
- Problems, costs, and methods of implementation;
- Relevant regulations and agency management
- Best international practices in terms of eligible subjects and trading condition transaction

During the kick-off meeting of 25 February 2014, Mr Pham Dinh Thuong, Deputy Director-General of the legal department of the Ministry of Industry and Trade (MOIT) said that dispute settlement was not the most important issue.
During a meeting held on 10 March 2014, the deputy-general of the legal department of MOIT mentioned that only futures with commodities as underlying asset are the subject of this study, and futures with securities as underlying assets are not. Accordingly the latter will not be discussed in the report.

II. Basic Introduction to Commodity Exchanges, Forward and Futures Transactions

1. Forward Transactions; Physical Delivery

Forward transactions may be defined as sale/purchase contracts by which the parties agree to buy and sell a certain good (commodity) or a certain quantity of a commodity at a price agreed upon when the contract is entered into for delivery at an agreed date in the future. In its most simple form these contracts provide for physical delivery of the commodity at the agreed time. By such contract the parties usually intend to cover uncertainties and risks for the future: the seller (usually the supplier or producer) of the commodity wants to avoid the risk that there will be no purchaser of his commodity in the future or that the price will be lower than he wants; the buyer wants to avoid the risk that there will be no supply of the commodity when he needs it or that the price will be higher than he wants. Parties avoid the risk of price fluctuations and "lock the price".

Example: during the growing season the (cooperative of) coffee grower(s) wants to be sure that it can sell the coming harvest of coffee beans at a price that is sufficiently high for it and it finds a company that processes (roasts) the beans and that is willing to buy the beans at this early date at the agreed price - so that it is certain that it will have adequate supply and it does not pay more than the agreed price if the market price rises. At the same time (so: before physical delivery of the coffee beans), the roasting company wants to be sure that it will be able to sell the beans that is has bought but not received, at an agreed price to a supermarket or to wholesale company.

Other examples are the steel company that wants to ensure that it will have sufficient supply of iron ore and coal at a certain price so that it can meet its obligations to its clients during the coming year or the airline that wants to be certain that it will have sufficient kerosene during a defined period and at a set price. The steel company and the airline have to find sellers (a mining company, an oil refinery) that is willing to sell and deliver (the quantity of) the good that meets all the specifications and at the time and price required by the buyer.

2. Developments

Typically, this simple form of forward contract may undergo several developments:

a) The number of sellers and buyers and the number of transactions of the good for delivery in the future becomes so big that a market starts to exist.

For a market to function, the risk of non-performance of buyers and sellers (counterparty risks and trading risks) must be eliminated. This means:

- Buyers want to be and can be certain that there will be sellers able and willing to deliver the agreed quantities of the good of the agreed quality and at the agreed price and time. Therefore, liquidity is required.
- Sellers want to be certain that they will receive the agreed purchase prices.

b) The foregoing means that contracts often become standardised: quantities, quality characteristics ("specifications") and time of delivery become standardised (prices don't).

- Example: using standard contracts, coffee growers sell in January coffee beans of a certain guaranteed quality for delivery in June.
- If parties want to enter into transactions for which no standardised contracts exist, they may enter into a bilateral transaction over-the-counter ("OTC") which is customised to their specific needs.

3. No Physical Delivery; Futures

Buyers and sellers will do not only enter into contracts for physical delivery of the commodity but will try to benefit from a difference between the agreed forward price and the price they are able to obtain either in the market at the time of delivery or by entering into another forward contract at a different price.

- Example: the steel company (party A) that has bought iron ore of a certain quality and other characteristics in January from a mining company (party B) for delivery in June at a certain price, sells the same quantity and quality of iron ore to another company (party C) for delivery in June as well but at a slightly higher price. At settlement date, party A receives the original purchase price from party B and delivers the ore to party C who pays the higher price to party B. Party B makes a profit equal to the difference between the second and first purchase price.

- (Financial) parties come to the market that has no interest in actual delivery of the good. While the (standardised) contracts still refer to the delivery of a certain quantity and quality of a good at a certain date, these parties may continuously buy and sell these contracts in order to make a profit from the price differences. In other words, most contracts are cancelled out by purchasing a covering position - that is, buying a contract to cancel out an earlier sale (covering a short), or selling a contract to liquidate an earlier purchase (covering a long). Nevertheless, eventually the goods will be delivered by the seller to the buyer at beginning and end of the chain of contracts (minus transaction costs - commissions and fees).

- These financial contracts may be called futures as opposed to forward contracts that intend to provide for actual delivery of goods. Futures contracts are standardized according to the quality, quantity and delivery time and location for each commodity. The only variable is

price.
However, the terms “forwards” and “futures” do not always have the same meaning.

4. Other Goods

Contracts are (and have been) developed for many goods - originally for agricultural commodities, followed by metals and minerals; later for financial products such as shares, bonds, stock indices, foreign currencies (forex) and other. As mentioned futures contracts for financial products are not discussed in this report.

5. Hedgers and Speculators

Some parties enter into forward and futures contracts to protect (hedge) themselves against unwanted price fluctuations; other parties use these contracts mainly or only to profit from price differences and speculate.

Hedgers are individuals and firms that make purchases and sales in the futures market for the purpose of establishing a known price level, weeks or months in advance, for something they intend to buy or sell later in the cash market. In this way they attempt to protect themselves against the risk of an unfavorable price change in the interim. Whatever the hedging strategy, hedgers willingly give up the opportunity to benefit from favorable price changes in order to achieve protection against unfavorable price changes.

Speculators are individuals and firms who seek to profit from anticipated increases or decreases in futures prices. Someone who expects a futures price to increase will purchase futures contracts in the hope of later being able to sell them at a higher price. This is known as “going long”. Someone who expects a futures price to decline will sell futures contracts in the hope of later being able to buy back identical and offsetting contracts at a lower price. The practice of selling futures contracts in anticipation of lower prices is known as “going short”.

One of the unique features of futures trading is that one can initiate a transaction with a sale as well as with a purchase.

6. Aspects of the Price

- Futures prices increase and decrease largely because of the many factors that influence the views of buyers and sellers about what a particular commodity will be worth at a given time in the future (anywhere from less than a month to more than two years). As new supply and demand developments occur and as new and more current information becomes available, these judgments change, and the price of a particular futures contract may go up or down.
  Thus, in January, the price of a July futures contract would reflect the views of buyers and sellers at that time as to what the value of a commodity will be when the contract expires in July. On any given day, with the arrival of new or more accurate information, the price of the July futures contract might increase or decrease.

- Sometimes, exchanges establish the minimum amount with which the price can fluctuate upward or downward. They may also establish the maximum amount by which the price may fluctuate from the closing price on the previous trading day (the daily price limit). Once the upper or lower daily price limit has been reached, trading at a yet higher or lower price is not permitted on that trading day.

7. Margin

Exchanges set a margin, that is a deposit that the person or company that buys futures has to deposit with his broker and from which the broker can draw, to cover losses caused by price increases (for the buyer) or price decreases (for the seller) of the futures. Based on market developments and perceived risks, the exchange may require additional margin. The broker may require that his client pays more margin than the exchange requires.

There are two types of margin: initial margin and maintenance margin. Initial margin (sometimes called original margin) is the sum of money that the customer must deposit with the brokerage firm for each futures contract to be bought or sold. On any day that profits accrue on the open positions of the customer, the profits will be added to the balance in the margin account. On any day losses accrue, the losses will be deducted from the balance in the margin account.

When the funds remaining available in the margin account of the customer are reduced by losses to below a certain level - known as the maintenance margin requirement - the broker will require that the customer deposit additional funds to bring the account back to the level of the initial margin. The customer may also be asked for additional margin if the exchange or the brokerage firm raises its margin requirements. Requests for additional margin are known as margin calls.

8. Options

An option on a futures contract gives the option-buyer the right - but not the obligation - to buy or sell a particular futures contract at a stated price at any time prior to a specified date, or at a certain date.

There are two types of options: calls and puts. A call option gives the option buyer the right to purchase a particular futures contract at a stated price at any time during the life of the option. A put option gives the option buyer the right to sell a particular futures contract at a stated price at any time during the life of the option.

The buyer of the option pays the seller a purchase price, the premium.

Options on futures are not further discussed in this introduction.

9. Clearing and Settlement

In order to minimise or exclude the counterparty risk, many exchanges create a separate entity, the clearing house or institute that by way of novation of the contracts becomes the only

counterparty of each party that enters into a transaction of a futures contract on the exchange instead of the initial counterparty. To this end, each trading day all members must report all buys and sells to the clearing institute (in some exchanges through clearing members).
The clearing institute then ensures that financial settlement is made from all buyers and sellers to the clearing institute. The clearing institute guarantees all contracts by requiring that all market participants maintain a cash deposit, i.e. the margin discussed before.
By maintaining a Guarantee Fund the clearing institute guarantees the proper performance of all contracts concluded on the exchange.

Over-the-counter (OTC) transactions are not traded on the exchange and will not be guaranteed by the clearing institute; therefore the counterparty risk will exist. Usually, physical delivery and payment under these transactions are settled bilaterally between the parties to the contract. However, the price of such transactions are often based on the prices on the exchange

If the parties have the intention that physical delivery of the commodity will take place, the clearing institute accepts warehouse receipts (instead of the commodity) from the seller and transfers these receipts to the buyer. Warehouse receipts are issued by the warehouse company where the commodity is stored and the holder of the warehouse receipts is recognised as owner of the quantity and quality of the commodity described in the receipt. Following transfer of the warehouse receipt, the buyer can claim delivery from the warehouse company.

However, as mentioned before, most futures contracts are cancelled out by purchasing a covering (i.e. counter-) position - that is, buying a contract to cancel out an earlier sale (covering a short), or selling a contract to liquidate an earlier purchase (covering a long).
If the parties intend cash settlement, settlement will be based on the underlying spot price. The parties settle by paying/receiving the loss/gain related to the contract in cash when the contract expires.

10. Parties in Commodities Transactions, Members of Commodity Exchanges

Definitions vary from country to country and from exchange to exchange but in general the following parties are members of commodity exchanges and involved in commodities transactions:

a) A commodity trader is a firm or individual who trades for his own account.
Note: articles 17 - 25 of Decree 158/2006/ND-CP provides for a different definition and different activities of “trading members”.

b) A commodity broker is a firm or individual who acts as intermediary and executes orders to buy or sell commodities for its clients and puts the two counterparties together in a trade, and charges them a commission.

c) A commodity dealer is a firm or individual who buys and sells commodities on his own account. Dealers make a profit by buying low and selling high. They trade with their clients (traders) taking the reverse side and they do not execute their clients’ orders.

d) A clearing member is a broker or dealer which is admitted as member of a clearing house. In order to be admitted a clearing member must satisfy capital and other requirements of the clearing house. Usually only financial parties and large trading houses can become clearing members.

11. Transactions and Parties in International Markets; Trade Finance

In international markets, market parties are usually major trading houses[1] or financial parties such as banks with sizable financial resources. The reason is that international exchanges (such as Liffe in London, the largest market for Robusta coffee and ICE in New York, the largest market for Arabica coffee), require their members, in particular the clearing members, to have a large capital.

Banks often have an additional role: providing trade finance to their customers on the basis of collateral in the form of a temporary purchase of a stock of commodity from the customer followed by the sale of the same commodity to the customer when the loan is repaid. When the bank makes a loan, it will make the amount of the loan available by purchasing a certain quantity of a commodity and paying the purchase price to the customer with the agreement to sell the same commodity back to the same customer at a later date through an exchange (repo transaction). The purchase price that the customer will pay to the bank constitutes repayment of the loan. In such transactions, the bank acquires temporary ownership of the commodity to secure the loan, and not to take physical delivery of the commodity.

Other parties, such as roasters and intermediate traders, may want to have physical delivery and enter into a bilateral OTC transaction. In such case the price is usually based on the settlement price on an international exchange (such as Liffe in London) but actual delivery and payment will take place bilaterally between the parties to the contract.
It is noted that traders do not make profit so much on differences between purchase and sales prices but on fees and other payments for additional services in the supply chain, such as transportation, storage, quality control, etc.

12. Dispute Settlement

Disputes may exist between the exchange and one or more of its members, between members (e.g. a broker and a trader) and between a member and its customer. Investors expect that any exchange have a transparent system for the settlement of such disputes by an independent and impartial institution applying generally accepted procedures.

The rules of several exchanges provide that complaints shall first be submitted and be reviewed by conciliation or mediation panel organised by the exchange itself[2]. If this process does not

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[1] Examples are Cargill, Glencore, Trafigura and Vitol.

settle the dispute within a certain time (for example one month), either party may refer the matter to arbitration, where plaintiff and defendant each appoint one arbitrator and the two arbitrators jointly appoint the chair of the panel. Obviously, the arbitrators must be impartial and independent from the exchange, from the parties to the dispute and from all government institutions. In addition, there must be rules for the enforcement of the arbitral award in the country itself and abroad.

13. Conditions for Viable Commodity Trade

Both forward and futures transactions with and without physical delivery and trade finance will only be successful if certain conditions are satisfied. These include:

a) Legal matters

A transparent, enforceable legal system with clear rules regarding

- ownership and transfer of title
- security rights
- warehouse receipts
- a transparent system for independent and impartial settlement of disputes,

b) Practical matters

- liquidity of the market with a large number of sizable sellers and buyers willing and able to do transactions
- a reliable system of storage, warehouses
- quality control services (standards and specifications)
- insurance
- No default risk, i.e. certainty that suppliers will deliver the agreed quantity and quality, just in time.

International exchanges and their clearing houses often offer solutions for the last mentioned "practical matters" in the form of additional services. For example, if the commodities are traded via the exchange, physical delivery may only take place from warehouses that are approved by the exchange. Moreover, quality controllers of the exchange will take samples in the warehouse where the commodity is stored and tests will be performed in London (where Liffe is established).

A complication for Viet Nam is that many warehouses in Viet Nam are not approved by international exchanges so that internationally traded commodities are often not stored in Viet Nam (the country of origin) but in Europe or North America. This is redressed to some extent if international storage companies lease and manage warehouses in Viet Nam on an annual basis and ensure that international standards are maintained[3].

Another complication for Viet Nam is that there is no law for warehouse receipts. Warehouse receipts are issued by the company that holds goods in storage to the owner of the commodity

[3] Examples of these companies are: Steinweg, Unicontract, Katoennatie, Molenburgnatie, CWT Sitos, Pacorini. These companies may prefer ownership of long term leases of the warehouses but the law of Viet Nam does not permit this so that they rent the facilities on an annual basis.

described in detail (quantity, quality, specifications). The holder of the warehouse receipt is recognised by the issuer as the owner of the described commodity and can request physical delivery - or create a security right over the commodity. The lack of a legal system of warehouse receipts in Viet Nam is one of the impediments for viable commodity trade to develop in Viet Nam[4].

IV. Relevant Authorities and Legislation in Viet Nam

1. Ministry of Industry and Trade

The Ministry of Industry and Trade ("MOIT") is in charge of commodity exchanges and forward transactions. The relevant laws, rules and regulations are:

- ii. Commercial Law 2005, articles 63 - 73 (Purchase and Sale of Goods through the Goods Exchange)
- iii. Decree 158/2006 MOIT, detailing the implementation of the commercial law regarding goods purchase and sale through the goods exchange
- iv. Circular 03/2009 MOIT

Note: Articles 63 and 64 of the Commercial Law refer only to forward and option contracts for physical delivery of the underlying goods. However, Article 65 (Rights and obligations of parties to forward contracts) refer to the situation that the buyer makes cash payment and rejects the goods or the seller refuses to deliver. This suggests that the Commercial Law does not only apply to forward contracts with physical delivery but also to futures (cash settled contracts), but this not entirely clear. Decree 158/2006/ND-CP does not clarify the issue but seems to have been written for physical trades and not for financially settled contracts.

Questions for PMU experts: can you please investigate

- *Has the intention of the authors of the Commercial Law Articles 63-73 and of Decree 158/2006 been that these documents relate only to forward contracts with physical delivery or also with financially settled futures?*
- *Just futures contracts*
- *How do the authorities, particularly the MOIT, interpret these articles and do they apply the Commercial Law and Decree 158/2006 both to forward contracts (with physical delivery in the future) and to futures contracts (financial settlement, no physical delivery)?*
- *->Futures contracts, and in futures exchange, Physical delivery shall take place at the end of contract (delivery month) even at a very small percentage (normally 2-5%; 98-95% are financial settled)*

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[4] DMI expert 2 has been informed that sometimes this impediment is solved when the entity that belongs to an international trading group and that rents warehouse facilities in Viet Nam, issues a certificate or warrant with form and system of a warehouse receipt. When guaranteed by the parent company or by a substantial other entity of the same group, the stock in the warehouse in Viet Nam will be generally recognised and used for trading and as collateral.

- *Can you analyse articles 63-73 of the Commercial Law, Decree 158/2006 and Circular 03/2009?*
  -> All about futures exchange

2. Ministry of Finance, the Securities Law

The Ministry of Finance is in charge of the securities market and the insurance market.

Although several definitions in Article 6 (Interpretation of Terms) of the Securities Law suggest that the Securities Law is relevant for futures and option contracts[5], both the deputy-director general of the legal department of MOIT and PMU expert 6 have stated that the term futures in articles 6 and 7 of the Securities Law refers to futures with securities (shares, bonds, etc.) as underlying assets. As futures with securities as underlying asset are not subject of this report, the Ministry of Finance and the Securities Law are not discussed.

3. State Bank of Viet Nam

The State Bank of Viet Nam (the "SBV") is in charge of the money market and the foreign exchange market. It is fair to assume that the role of the SVB regarding the foreign exchange market is prompted by the fact that the Vietnamese dong is not convertible in other currencies.

The basic legal instrument is the Law on Credit Institutions 2010.[6] This Law does not mention commodity based derivative (futures) transactions. Article 4.23 of the Law defines derivatives as financial instruments where the underlying asset is an exchange rate, interest rate, foreign exchange, currency or other principal assets. Nevertheless, the State Bank regulates certain cross border futures transactions by commercial banks on the basis of Article 107 of the Law on credit institutions[7]. Thus, the SBV has issued Official Letter 1229[8] regarding commercial banks that participate in swap transactions with overseas parties.

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[5] Article 6 of the Securities Act defines the term "Securities" in paragraph 1. to include "(b) Share purchase rights, securities rights, purchase options, sale options, future contracts, groups of securities and securities indices".
Paragraph 7 of Article 6 states: "Purchase option or sale option means a right stipulated in a contract which entitles a purchaser to choose the right to purchase or to sell a pre-determined volume of securities at a pre-determined price during a specified period.
Paragraph 8 of Article 6 states: "Future contract means an undertaking to purchase or sell a specified type of securities, group of securities or securities index at a pre-determined volume and pre-determined price and on a pre- determined date in the future".

[6] The information in this paragraph is based on information given by Ms. Bui Hang of State Bank of Viet Nam during a meeting on 10 March 2014.

[7] Art. 107 states: "Other business activities of commercial banks

1. Provision of such services as cash management, banking and financial consultancy, asset management and preservation, and safe keeping.
2. Consultancy of corporate finance, business acquisition, sale, consolidation and merger and investment.
3. Trading in government bonds and corporate bonds.
4. Monetary brokerage services.
5. Securities depository, gold trading and other business activities related to banking operations after obtaining the State Bank's written approval."

Typically commercial banks "sit in the middle" when a customer wants to enter into a commodity based derivative transaction with an overseas party.

The rules as described in OL 1229 for swap transactions are:
- The commercial bank must apply for SBV approval
- The type of commodities must be specified
- If granted, the approval applies not for each single transaction but for a certain type of transactions generally
- The commercial bank may enter into transactions with domestic customers generally in dong on the one hand and with overseas parties in USD on the other hand (so the bank enters into 2 identical contracts, back to back, and legally it is party to both contracts, but it has no market risk - it will have counterparty risk)
- The transactions must be for financial settlement, not for physical delivery
- The domestic customer may use the derivative only for hedging purposes
- The domestic customer must have physical stock equal to the value of the derivative
- The maximum amount of possible loss must be no more than 5% of the own capital of the commercial bank.
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Options and futures with overseas parties are not standardised and unusual, and are traded only OTC with high value. The SBV issues similar rules as described above on a case-by-case basis for interest and futures derivatives.

If a domestic trader exports commodities and receives foreign currency, there is no problem and no foreign exchange regulation.

If a domestic trader imports commodities, either spot or forward, and needs to pay foreign exchange abroad, it needs approval from SBV. The commercial bank that will perform the payment will apply for approval.

For domestic commodities (forward and futures) trade, the SBV has not issued rules. Banks do not seem active in the domestic commodities market.

Questions for PMU experts: can you please investigate:
- *Can you double-check the above information with the State Bank? Ok*

- *Can you make an English translation of OL 1229 of 21 October 2003?*
  We would give a brief

- *Has the SBV issued any other regulation or Official Letter for the purchase by a Vietnamese party (commercial company or bank) of a commodity (e.g. steel) from a foreign party, either spot or forward (or future), and payment of the purchase price in dong or other currency?*

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[8] OL 1229/NHHH-CSIT of 21 October 2003 (OL 1229) to regulate commodity price swap transactions between a Vietnamese enterprise and a commercial bank in Viet Nam.

No SBV is just granting commercial banks as a try

- *What are the rules regarding the sale of a commodity (forward or future) by a Vietnamese party to a foreign party and the receipt by the Vietnamese party of the price (in dong or in foreign currency)?*
  No rule so far
- *Has the SBV issued any Official Letters or rules regarding domestic forward and futures transactions, in particular, does SBV prohibit short transactions, in general or to Vietnamese banks?*
  No it does not. Under decree 158, it is responsible for drafting a circular on clearing house but not completed
- *Are there any rules (of MOIT, MoF, SBV or other government institution) regarding the participation by foreign/international parties in Vietnamese commodity markets?*
  There is no rule on this. The report should make a recommendation on this (e.g. issuing legal documents on this)
- *Are there any rules (of MOIT, MoF, SBV or other government institution) regarding the participation by Vietnamese parties, in particular banks, in foreign/international markets?*

MOIT is drafting a circular on this

V. Commodity Exchanges in Viet Nam

1. General; Important Commodities

Viet Nam's most import agricultural products and exports are: pepper, Robusta coffee, rice, cashew nuts, vegetables and fruit, rubber and fishery products. Viet Nam is the world's largest producer and exporter of Robusta coffee with an export volume of approximately 1.5 million tons.

In 2010 MOIT authorised 8 commodities, all related to coffee, rubber or steel for trading through the Commodity Trading Agency[9]. Gold and Silver, being the most anticipated commodities by local investors, were not on the list of commodities authorized for trading on the commodity trading floor.

Question for PMU experts:

Can you search for (English translation) of the Decision of the Minister of the Ministry of Industry and Trade dated 18 August 2010, No. 4361/ QD-BCT to announce the list of

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[9] On 18 Aug 2010, the Minister of the Ministry of Industry and Trade passed the Decision dated 18 August 2010, No. 4361/ QD-BCT to announce the list of commodities authorized for trading through the Commodities Trading Agency. The commodities are: - Non-roasted, non decaffeinated coffee beans (Industrial code H.S 0901.11); - Non/pre-rubberized natural rubber (Industrial code H.S 4001.10); - Natural rubber in the form of baked rubber sheet (Industrial code H.S 4001.21); - Treated natural rubber (Industrial code H.S 4001.22); - Rolled non-alloy steel products of 600mm and above in width, heat rolled, pre-coated, pre-plated, or pre-laminated (Industrial code H.S 7208); - Rolled non-alloy steel products of 600mm and above in width, cold rolled (cold pressed), pre-coated, pre-plated, or pre-laminated (Indus- trial code H.S 7209); - Rolled non-alloy steel products of 600mm and above in width, coated, plated, or laminated (Industrial code H.S 7210); - Non-alloyed steel products in bar and rod forms, that have only been forged, heat rolled, heat stretched, or heat squeezed, including post-rolling twisting (Industrial code H.S 7214). The Decision takes effect on 18 Aug 2010.

commodities authorized for trading through the Commodities Trading Agency and any amendment thereof?
Yes, we can

The supply chain of the relevant commodities can be summarised as follows.

- Coffee[10]:

- Producers of coffee in Viet Nam are small individual farmers with only 1 - 2 hectares who produce 2,000 - 3,000 tons of coffee per hectare per year, one crop per year.

- Farmers sell to local traders (family enterprises); local traders sell to bigger traders in the villages and towns, mainly private enterprises; the town traders sell to larger provincial traders and to export traders. These are private and state. Export traders sell to foreign traders.

- Of total annual production, around 90% (around 1.5 million tons) is exported, as raw unprocessed beans. Processing (roasting) of the beans takes place abroad.

- PMU experts: can you please add similar summaries for rubber, pepper, cashew nuts, rice, fruits?

We will refer to MOIT

2. Experience with Domestic Commodity Exchanges

The publications that DMI expert 2 studied and the interviews that he conducted lead to the conclusion that commodity market, forward and futures transactions are not yet fully developed in Viet Nam.

Currently, the MOIT has issued licenses to two institutions to establish a commodity exchange in Viet Nam:

a) Viet Nam Commodity Exchange (VNX)

In 2010 the Ministry of Industry and Trade has issued a licence to Viet Nam Commodity Exchange (VNX) for three products: coffee, rubber and steel[11]. VNX opened in Ho Chi Minh City in January 2011. VNX offered a trading platform for futures, swaps and brokerage, a payment center and a commodity transaction and appraisal center (including settlement).

A report of VNX shows that in the first quarter of 2012, the total contracted transaction volume was 12,000 lots only with a trading value of 530 billion dong. The figures were 93,000 lots and 7300 billion dong in the whole year 2011. Most of the transactions were in the coffee sector,

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[10] Information provided by Mr. Doan Hong Quan of Ocean Group during meeting on 5 March 2014.

[11] Decision of Ministry of Industry and Commerce No.4596/GP-BCT dated 1 September 2010, corrected by Decision No. 0106/QD-BCT dated 10 January 2011

while there were few rubber transactions and nearly no steel transactions.

By March 2012, the trading floor's members had opened 1981 accounts at the trading floors. Most of the transactions have been made among individual investors, while the trading floor has not attracted institutional investors[12].

Due to internal problems, VNX suspended activities in 2013 but it will be re-launched in the spring of 2014[13].
Although VNX will in principle be open for trade in any commodity, the licence of MOIT applies for coffee, rubber and steel and initially only coffee will be traded.

VNX will use the product / model contract of Liffe (look alike). An American member of CME will enter into a joint venture with VNX, and it will do clearing and settlement, act as clearing member (to solve problem of insufficient liquidity), and can advise regarding contracts and rules. There will be a clearing house, a separate company with clearing members.

Members of the exchange will be
- Traders who buy and sell for their own account
- Brokers who open accounts for farmers etc.
- Clearing members who clear and settle[14].

The target members of the exchange will be mainly commercial banks and big domestic traders. Farmers cannot become members; they will sell their produce through members of VNX.

Initially there will be no warehouses, for storage of coffee stock; in the future there may be approved warehouses of third parties, but VNX will not have its own warehouses.

VNX will start with futures contracts, later options, thereafter maybe OTC contracts.
Based on oral information and publications received from VNX, DMI expert 2 believes that the major activity of VNX will be to enable Vietnamese traders and financial institutions to enter into hedging transactions for financial settlement on international exchanges like Liffe and ICE.
Question to PMU experts:
- According to the website of VNX, www.vnex.vn, two regulations have been issued (Trading Regulation VNX, Decision No. 18-2011[15] *and Member Regulation VNX, Decision No. 19-2011*[16]*). Can you please analyse these regulations?*

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[12] The information above is derived from several articles published in Talk Viet Nam, http://talkViet Nam.com/tag/vnx/, read on 4, 5 and 6 March 2014.

[13] This and the following information have been obtained during an interview with Mr. Nguyen Duy Phuong of Viet Nam Commodity Exchange VNX on 13 March 2014.

[14] Information material that was given to DMI expert 2 during his meeting with VNX of 13 March 2014 distinguishes Clients, Brokerage Members and Proprietary Members of VNX. DMI expert 2 assumes that Clients are the same as the abovementioned Traders; and that Brokerage Members are the same as the Clearing members mentioned in the text above.

-> *We do not think the analysis of these documents is necessary*

b) Ocean Group, Info Comex

In May 2012 the Ministry of Industry and Trade issued a licence for a second commodity exchange, Info Comex, organised by Ocean Group[17]. The approved products are again coffee, rubber and steel but the exchange will start with coffee trades and with spot transactions with physical delivery only[18]. Trading members of the exchange will be (not small scale farmers and village-based traders but) intermediate traders (often town-based) who sell mainly to domestic export traders. The exchange will have an electronic trading platform, warehouses in five cities (the major production and trading centers - Dak Lak, Da Lai, Kon Tum, Lam Dong - plus Ho Chi Minh City) and head office in Hanoi.

As major hurdles have been mentioned

- Development of the software for the trading platform and
- The lack of a law on warehouse receipts. (Warehouse receipts and the stock of commodities for which they are issued can be used by traders as collateral to obtain loans from the banks. This can only be effective if there is a reliable legal system in place).

Based on oral information and publications received from Info Comex, DMI expert 2 believes that the major activity of Info Comex will be the organisation of an exchange for (initially spot, in the future also forward) transactions for domestic suppliers and traders.

Questions for PMU experts:

- *Can you update and complete the information regarding VNX and Info Comex/Oceangroup?*

VNS is restructuring and would resume by June. While Comex is preparing infrastructure and not ready to operate

- *In particular: can you obtain and analyse (English translations of)*
- *the licence issued by MOIT to Info Comex*
- *the Charters and further rules of VNX and Info Comex, including their Trading Regulations and Member Regulations?*

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15 VIETNAM COMMODITY EXCHANGE no. 18/2011/QD-VNX, SOCIALIST REPUBLIC OF VIETNAM, Independence-Freedom- Happiness, HCMC, 14 June 2011.

16 VIETNAM COMMODITY EXCHANGE no. 19/2011/QD-VNX, SOCIALIST REPUBLIC OF VIETNAM, Independence-Freedom- Happiness, HCMC, 14 June 2011.

17 Confirmed by Mr. Pham Dinh Thuong, MOIT, on 10 March 2014. See also "Second commodity exchange opens in Viet Nam", published in Viet Nam Breaking News, May 4, 2013, http://www.Viet Nambreakingnews.com/2013/05/second-commodity-exchange-opens-in-Viet Nam/, read on 4 March 2014.

18 Information in this paragraph has been given by Mr. Doàn Hong Quân of Ocean Group during meeting on 5 March 2014.

The licence is just granting a company the right to operate a commodity exchange. The analysis of the rules is not necessary and would take time.

According to publications on internet, there are two more futures exchanges but according to the deputy director general of the legal department of MOIT these are not licensed exchanges:

c) Buon Ma Thuot Coffee Exchange Centre (BCEC)

In 2007 the government has approved the establishment of a coffee transaction floor in Ban Me Thuot city, Dak Lak province. The construction was scheduled to be carried out by the host province of Dak Lak and the Viet Nam Coffee and Cacao Association (Vicofa). The transaction floor is a merging place for coffee producers and businesses to introduce their products as well as processing data and prices. Via direct and public transactions, the floor will provide information concerning consumption markets and price tendency to facilitate the production of the producers[19].

In March 2011, Buon Ma Thuot Coffee Exchange Centre (BCEC) received Prime Ministerial approval to pilot coffee future transactions[20].

BCEC was allowed by the government to carry out coffee forward transactions on a trial basis for one year, commencing from March 2011. A report of BCEC showed that from March 2011 to December 2011, the total trading volume of the trading floor was 7000 lots only, valued at 600 billion dong.

The government has allowed BCEC to extend the trial operation period until the end of 2012. However, the center is facing big difficulties, when domestic enterprises do not intend to make transactions here, while coffee growers do have confidence on the floor.

However, future transactions at these Exchanges have failed to yield positive results witness low rates of matched transactions. For example, BCEC, despite its continual efforts in 2012, registered 2,722 lots of coffee on matched future transactions, equivalent to 5,444 tons of coffee.

d) Son Tin Merchandise Trading Floor STE

The Son Tin Merchandise Trading Floor STE belonging to Sacombank has also been gloomy. According to reports, 250,000 tons of steel was traded on STE in 2010, 180,000 tons in 2011.

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[19] See http://www.intellasia.net/coffee-transaction-floor-for-central-highlands-49666, read on 1 April 2014.

[20] See http://www.Viet Nambreakingnews.com/2013/08/commodity-exchanges-need-enhanced-legal-framework/#.Uzqalfl_uCo, read on 1 April 2014.

Especially, the trading floor was very gloomy in the first four months of the year with only 80,000 tons traded. Meanwhile, the fertilizer trading volume was inconsiderable[21].

Questions for PMU experts:

- *Can you update the description of BCEC, STE and possibly other organised markets in Viet Nam?*
  BCEC has skipped trading futures and is proposing to change to a form of joint stock company operating under the decree 158.
  STE is not a commodity exchange licensed, so we do not have much information on this
- *What are objectives and activities of BCEC and STE? Are they commodity exchanges where forwards and futures are traded?*
  The objective of BCEC is to be a modern commodity exchange but the capacity is weak. We understand all contracts traded in an exchange are futures or options (forwards is contract traded in OTC)

3. Trading on International Commodity Markets

In 2004, several Vietnamese banks began to act as secondary broker for domestic businesses to participate in *international* commodity exchanges, especially in futures transactions of Robusta coffee. According to the State Bank of Viet Nam's statistics, during the 2004-2012 period, all nine involved banks registered futures transactions worth of US$23.136 million[22].

The reason for this international activity may be that the parties (and the Vietnamese banks that act as their secondary brokers) seek the large markets with a high degree of liquidity - in the case of coffee, the NYSE Liffe Exchange (recently bought by ICE) holds the primary Robusta futures contract (while Viet Nam is the largest producer and exporter of Robusta) and the main global derivative contract for Arabica (of which Brazil is the largest producer and exporter) is the ICE futures contract. Furthermore, the main pepper market is in India: "Vietnamese pepper farmers use information at India's Kochi Commodity Exchange to regulate their prices because there is no domestic commodity exchange for them"[23]. For metals the London Metals Exchange (LME) is one of the most important exchanges.

The activities of the Vietnamese banks that participate in international futures exchanges (such as the LME, ICE and Liffe) show the following aspects:

- The Vietnamese banks act through foreign banks who trade as brokers on international markets

[21] See http://english.Viet Namnet.vn/fms/business/23256/merchandise-trading-floors-flutter.html, read on 1 April 2014.

[22] http://www.Viet Nambreakingnews.com/2013/08/commodity-exchanges-need-enhanced-legal-framework/#.Uzqalfl_uCo, read on 1 April 2014. The article mentions a total amount of US$23.136 billion but US$23.136 seems more likely.

[23] Statement by the chairman of the Viet Nam Pepper Association. See http://Viet Namnews.vn/economy/224891/commodities-trade-may-expand.html, read on 4 March 2014.

- The Vietnamese banks trade as secondary brokers for domestic customers (indirect participants), and always back-to-back so that they do not have a credit risk.

- The domestic banks need a licence from the State Bank. The requirements to obtain such licence are described in Section [21], above.

4. Summary and Conclusions regarding Commodity Markets in Viet Nam

a) Domestic Commodity Exchanges

Commodity markets are not yet a big success in Viet Nam. According to the chairman of the Viet Nam Pepper Association, the country is a leading agricultural exporter but it faces too many problems in developing trade. He said the commodity exchange for these items was vitally necessary[24].

The causes of this failure are manifold and include the fact that several of the legal and practical matters defined as conditions for a viable commodity trade in Section [18] above are not satisfied in Viet Nam.

There is insufficient market liquidity (particularly big parties with ample resources that will give producers the confidence that their produce will be bought, are lacking); - the warehouse, insurance and quality control system are insufficient; and the legal system does not provide for security rights, warehouse receipts and rules for independent and impartial dispute settlement.

Moreover, there is reason to doubt that domestic (small) farmers and intermediate traders have sufficient know how of and interest in forward and futures transactions.

b) Participation in Foreign Exchanges; Transactions with Foreign Parties

Direct participation by Vietnamese parties (banks, major traders) in international exchanges is probably hindered by the capital requirements of membership of those exchanges and the control and restrictions exercised by the State Bank of Viet Nam. Indirect participation, whereby Vietnamese banks act as secondary brokers between domestic customers on the one hand and member-brokers of international exchanges on the other hand are subject to restrictions and licences of the State Bank as well. The non-convertibility of the dong is a major cause of these impediments.

Vietnamese export traders of coffee, and possibly also of other commodities) do enter into forward transactions with foreign buyers. In addition to the normal foreign exchange controls, several of the causes of the failure of domestic exchanges mentioned in paragraph a) above, play a role here as well, such as the absence of proper warehousing and quality control systems and rules regarding warehouse receipts, security rights and dispute settlement[25].

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[24] See http://Viet Namnews.vn/economy/224891/commodities-trade-may-expand.html

[25] According to one report, the failure by Vietnamese commodity exchanges to develop is in part due to the restrictions on both the demand and supply sides of the hedging market.

On the supply side, the State Bank of Viet Nam keeps a tight grip on the commodity derivatives markets and to date only a handful of banks, including Techcombank, BIDV and Standard Chartered, have licences to offer commodity derivative products onshore. And even though the banks have been growing their businesses, actual market penetration remains consigned mostly to large players and non-state owned enterprises.

Questions to PMU experts

- *Can you further analyse why commodity exchanges are not a success in Viet Nam?*
- *Can you mention the advantages and disadvantages that commodity exchanges and futures transactions may have for Vietnamese parties (farmers, suppliers and traders?) We would think about it with a reference to MOIT*

The same report states that on the demand side the key remains educating market players about the ways that hedging can protect producers/suppliers and buyers (like traders, processing companies and wholesalers) from price fluctuations. See "Supply glut heats up Viet Nam coffee derivatives market", Author: Alex Davis, Source: Asia Risk | 16 Dec 2013, published in http://www.risk.net/asia-risk/feature/2318428/supply-glut-heats-up-Viet Nam-coffee-derivatives-market