

# FTSE prospects

## Hopes dashed until September 2021

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September 25, 2020

### **Any hopes of upgrade will need to wait until September 2021**

Any chance of an upgrade by FTSE to emerging market status can only occur in the next full annual review by September 2021. Although FTSE could signal an upgrade in the March 2021 interim review, we believe Vietnam will unlikely resolve the outstanding issues before this time.

### **Progress has been made to lift the main barrier which is clearing & settlement mechanism**

According to the State Securities Commission (SSC), an overarching upgrade of the trading system will be completed next year. We believe this will be an important improvement, creating a foundation for transition to the international DvP (delivery vs payment) mechanism since local practice still requires a pre-trading check on funds prior to any trade execution. We need to watch the following factors to track any progress on this issue: 1) the creation of a centralized counter-party (CCP); and 2) SSC's request for upgrading technological infrastructure of securities companies to prepare for DvP.

### **Fading hopes for FTSE upgrade unlikely to stem foreign capital outflows**

If the FTSE upgrade is delayed until next year, Vietnam will lose a significant catalyst to reverse foreign selling. Vietnam will not be immune to the capital outflow seen across the emerging market and this continues to be Vietnam's biggest challenge in the foreseeable future. Moreover, the deal calendar is sparse, with little chance of privatizations of state-owned companies, divestures or IPOs of large corporates in the upcoming months.

## FTSE hopes dashed

### Hopes for FTSE upgrade moved back to September 2021

Given our view that resolving the issue of DvP settlement will be a complex and require the full commitment from the State Securities Commission, we now believe that any potential upgrade to Emerging Market status at FTSE will be pushed back to September 2021 at the earliest. Even this date will be a moving target until we see clear signs from the State Securities Commission that it will address this issue. We look for policy action in the following areas as signs of progress: 1) Upgrade the transaction system and infrastructure to prepare for DvP; 2) creation of a centralized counter-party (CCP); and 3) SSC's request for upgrading technological infrastructure of securities companies to prepare for DvP.

### The infrastructure upgrade is expected to go live in 2021

According to SSC, the upgrade of the comprehensive trading, depository and clearing system is in the final stages of implementation and can start testing next year. The new infrastructure together with the emergence of the Central Clearing Partner (CCP) model will pave the way for meeting the DvP criteria.

### Creation of the Vietnam Deposit & Clearing Corporation should be the first tangible sign that the State Securities Commission is ready to introduce DvP settlement

Given indications from the Ministry of Finance and the State Securities Commission, we believe policy direction is heading towards the creation of a central counter party (CCP) model to introduce DvP to the local equities market. Vietnam has been using the CCP model for settlement in the derivatives market since launching in 2017 but upgrades will likely be needed to be applied to the cash markets. One positive development has been the recent addition to the new securities law that facilitates the transformation of the Vietnam Securities Depository (VSD) into the Vietnam Deposit & Clearing Corporation comprising two member entities: the Vietnam Securities Depository and the Vietnam Clearing Center. However, there may be a legal issue because the implement of CCP will change the operational structure of the depository banks and securities companies, but the Law of Credit Institutions has not had a mechanism for this kind of operation. We expect this problem to be solved soon.

### Better risk management and infrastructure of securities companies are required

We believe the State Securities Commission is primarily concerned that Vietnam is a young market and the premature move to DvP settlement could lead to a lot of failed trades and jeopardize the confidence in the settlement system. Therefore, it may take more time for securities companies to upgrade their infrastructure and improve risk management before adapting DvP settlements.

**Failed criteria in Clearing, Settlement & Custody but progress in the Market & Regulatory Environment area**

Failed criteria related to the DvP issue during the latest FTSE review were in Clearing, Settlement & Custody category, while progress was made in Market & Regulatory Environment area. Vietnam remained on the Watch List as a Frontier Market after the September 2020 review.

Two failed criteria in FTSE’s Secondary Emerging classification included:

- *Settlement – Rare incidence of failed trades*: Remained as “unrated” due to low supply of information from the State Securities Commission.
- *Settlement Cycle (DvP)*: Remained as “Restricted” due to the market practice of conducting a pre-trading check to ensure the availability of funds prior to trade execution.

**Table 1. Vietnam FTSE review – Failed criteria in Secondary Emerging classification**

CRITERIA	Secondary emerging	Vietnam	Frontier
<u>Clearing, Settlement and Custody</u>			
Settlement – Rare incidence of failed trades	X	N/A	X
Settlement Cycle (DvP)	X	T+2	

Source: FTSE

**Vietnam met criteria for new accounts and trading in stocks with full foreign ownership limits**

Main areas of progress were:

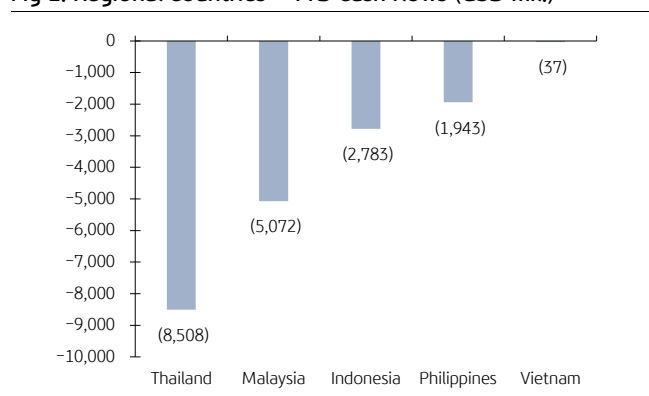
- Registration of new accounts: Market practice can extend the registration process.
- Foreign ownership limit stock trading: More efficient mechanism for foreign investors to facilitate trading stocks that have reached their foreign ownership limit.

**Foreign cash flow is unlikely to flourish in the future**

The global COVID-19 pandemic has triggered outflow from emerging markets and emerging Asia, with Vietnam also witnessing continued outflow on global recession fears.

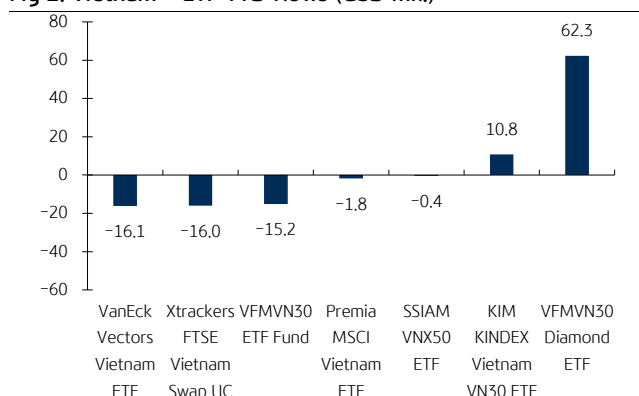
With an upgrade story likely to delay until the end of next year, we believe the foreign flow is unlikely to flourish in the future. Currently, the outlook is uncertain for any privatizations of state-owned companies, divestments or IPOs of large corporations.

**Fig 1. Regional countries – YTD cash flows (USD mil.)**



Source: Bloomberg & KB Securities Vietnam

**Fig 2. Vietnam – ETF YTD flows (USD mil.)**



Source: Bloomberg & KB Securities Vietnam

## Appendix 1. Vietnam – FTSE quality of market criteria

CRITERIA	Secondary emerging	Vietnam	Frontier
<b>World Bank GNI Per Capita Rating (Atlas Method)</b>		Lower Middle	
<b>Credit Worthiness</b>		Speculative	
<b>Market and Regulatory Environment</b>			
Formal stock market regulatory authorities actively monitor market	X	Pass	X
Fair and non-prejudicial treatment of minority shareholders		Restricted	
No or selective incidence of foreign ownership restrictions		Restricted	
No objection to or significant restrictions or penalties applied to the investment of capital or the repatriation of capital & income	X	Pass	X
No or simple registration process for foreign investors		Restricted	
<b>Foreign Exchange Market</b>			
Developed foreign exchange market		Restricted	
<b>Equity Market</b>			
Brokerage – Sufficient competition to ensure high quality broker services	X	Pass	
Transaction costs – implicit and explicit costs to be reasonable and competitive	X	Pass	
Stock Lending is permitted		Restricted	
Short sales permitted		Not met	
Developed Derivatives Market		Restricted	
Off-exchange transactions permitted		Not met	
Efficient trading mechanism		Restricted	
Transparency – market depth information / visibility and timely trade reporting process	X	Pass	X
<b>Clearing, Settlement and Custody</b>			
Settlement – Rare incidence of failed trades	X	N/A	X
Settlement Cycle (DvP)	X	T+2	
Central Securities Depository	X	Pass	
Central Counterparty Clearing House (Equities)		Not met	
Settlement – Free delivery available		Not met	
Custody-Sufficient competition to ensure high quality custodian services	X	Pass	
Account structure operating at the Custodian level (securities and cash)		Not met	

Source: FTSE, KB Securities Vietnam

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## Investment ratings & definitions

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### Investment Ratings for Stocks

(based on expectations for absolute price gains over the next 6 months)

Buy:	Hold:	Sell:
+15% or more	+15% to -15%	-15% or more

### Investment Ratings for Sectors

(based on expectations for absolute price gains over the next 6 months)

Positive:	Neutral:	Negative:
Outperform the market	Perform in line with the market	Underperform the market

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