Technical Report – Analysis Phase

Financial Sector Regulatory Issues

Lao Business Forum 2019

Updated and Final Version

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Introduction

The National Implementation Unit (NIU) of the Ministry of Industry and Commerce (MOIC) requested a study of banking regulatory issues to be discussed at the 2019 Lao Business Forum (LBF). The study was performed under the supervision of the Secretary General of the Lao National Chamber of Commerce and Industry (LNCCI). Funding for the study was provided by the Lao Competitiveness and Trade Project.

The LBF is widely recognized by both government and private sector as an effective high level policy dialogue to address specific issues affecting the private sector in Laos. At the previous LBF, the financial sector working group raised two issues:

- The regulation of the net interest spread; and
- The taxation treatment of unrealized foreign exchange gains or losses.

The objective of the study was to assess and review the existing legal and regulatory frameworks that have potentially negative impacts on the banking and financial sector and to provide concrete policy recommendations addressing the two issues above, ensuring that financial regulations promote credit expansion, especially among small and medium enterprises. More specifically, the mission objectives are:

- To evaluate the impact of the restriction on net interest spread on credit expansion, showing as clearly as possible with the information made available, how the said banking policy affects commercial banks' ability to operate lending activities efficiently, and to recommend practical solutions to this issue, including references to international examples; and
- To analyse the effect of taxation of unrealized gains on financial services providers and to propose key recommendations on whether the unrealized gains from foreign currency deposits should or should not be taxable based on results of evidence-based analysis (to the extent possible with the information made available), and international good practice.

This report presents the impact analysis of the two above issues, updated with the findings from a field mission which took place in April - May 2019 (schedule provided in annex).

An earlier draft version of this report was provided to the Bank of Laos for comment in October 2018 and the draft report also received wider circulation within the banking community.

Executive Summary

Interest rate cap regulations

Interest rate cap regulation was issued by the Bank of Laos (BoL) in 2015. The regulation capped Lao Kip (LAK) deposit rates and capped the difference between deposit and loan interest rates at an average of 4%. The BoL introduced a further regulation in late 2017 capping the average spread between lending and deposits rates in foreign currencies at 3%. Caps applied to the commercial banking sector only.

The introduction of the LAK caps in 2015 had an immediate effect and brought down LAK lending and deposit rates by some 3%. The caps can therefore be considered "binding with the cap rate set well below market rates", as all banks were offering the same lower interest rates from then onward.

With the introduction of an interest rate spread cap for foreign currencies of 3% in December 2017, interest rates in currencies started to drop and this cap can be considered "binding" as well. Foreign currencies (principally USD and THB) represent around 50% of banking sector volume.

After the introduction of the first LAK interest caps in July 2015, lending shifted to foreign currencies where credit volume started to exceed LAK credit volume. Foreign currencies were taking an increased share of credit volume and rolling back the de-dollarization achievements made over previous years. With the introduction of further caps and other restrictions on currency lending in 2017, currency lending growth started to drop significantly and in even became negative during the first quarter of 2018. Both LAK and foreign currency credit growth was very weak during 2018.

Although the study lacked the data to perform a statistical causal analysis of the impact of the caps, evidence points to a contraction in lending, re-dollarization and declining profitability of the banking sector.

After the introduction of the caps, the net interest margin of the banking sector declined to around 2.5%, which is low compared to margins in other countries with a similar economic and credit quality environments as Lao. In early 2018, the overall cost-to-income ratio of the Lao banking system was above 80%, leaving little or no room for further network expansion and capital formation to support a growing business. Return on Assets (RoA) and Return on Equity (RoE) of the Lao banking system are low by international standards, impacting banks' ability to maintain and build an adequate capital position and ultimately posing a systemic risk.

The experience with interest rate caps in Lao is similar to international evidence of the use of caps in other countries. A recent World Bank study[1] provides a comprehensive overview of interest rate caps around the world. Case studies contained in the World Bank study indicate that some forms of interest rate caps can indeed lower interest rates and help limit predatory lending practices by formal lenders, however interest rate caps often have substantial unintended side-effects. These side-effects include increases in non-interest fees and commissions, lower credit supply and loan approval rates for small and risky borrowers, reduced branch density as well as adverse impacts on bank profitability.

The initial impact analysis study was followed by a field mission in order to obtain comments and feedback of stakeholders on the initial technical report's conclusions and recommendations. During a mission in April-May 2019 some ten banks were interviewed and it was confirmed that the interest rate cap regulations had been effectively repealed by the Bank of Laos on 12 February 2019 through issuance of Agreement nr. 140/BoL (see Annex) and that banks are now free again to set their own deposit and lending interest rates.

The potential impact of the repeal is that credit availability will be stimulated, as banks can now charge appropriate interest rates and margins to cover the (high) cost of risk of lending in Lao. Banks now have added flexibility for risk based pricing, which should improve access to finance for (higher-risk) small and medium sized enterprises. Banks are also now in a better position to compete for deposit funding, especially in LAK where there seem to be liquidity bottlenecks.

Over the medium term, it is expected that improved interest rate margins will address structural banking sector profitability issues in Lao (low RoA and RoE) which should allow once more for banks to invest in growing their business footprint, customer service and network outreach. Repeal of the cap regulations lessens the regulatory reporting and administrative burden placed on banks, allowing cost savings and banks to improve their (high) cost-income ratios

Repeal of the caps also makes for a level playing field as banks can now compete on interest rates again with microfinance institutions and leasing companies that had not previously been subject to the interest rate cap regulations

Taxation of unrealized foreign exchange gains and losses

During the 2018 LBF, the Lao Banking Association raised the issue that gains from foreign exchange movement on account closing date (unrealized gains) were treated as taxable earnings. Commercial banks argued that unrealized gains should not be subject to taxation because these gains are only on paper while no actual transactions ever take place. The concern was that as the foreign currency deposits account for 52% of total deposits (Bank of Laos annual report 2016), imposing tax on unrealized gains incurs costs for commercial banks which could lead to higher borrowing costs thus causing a negative effect on credit access.

[1] Interest rate caps, the theory and the practice by the World Bank's Finance, Competitiveness and Innovation Global Practice, published in April 2018

A high-level impact analysis show that FX revaluation gains or losses are significant in the banking sector given the large externally financed position of the banking system. Swings in foreign exchange rates can create significant (realized and unrealized) revaluation gains and losses, the taxation of which could potentially amount to 65% - 85% of all taxes paid by the entire banking system in a given year.

As part of the preparatory analysis, publications from international tax advisory firms on Lao corporate profit taxation were reviewed. These publications however indicate that foreign exchange differences in Lao are taxable or deductible only when they are realized. This would confirm international tax practice in other regional jurisdictions[2] that revenues from foreign exchange differences are taxable or deductible only when they are realized.

The purpose of the field mission in April-May 2019, was to clarify and further investigate the assertion made by the Lao Bankers Association that gains from foreign exchange movement on account closing date (unrealized gains) are treated as taxable earnings.

A meeting was held with the Lao Bankers Association on 22 April 2019 in which they were not able to further clarify their earlier assertion made in 2018. In subsequent meetings with some ten different commercial banks (see meeting schedule contained in Annex), none of the banks raised concerns with the tax treatment of unrealized foreign exchange gains and losses. Upon consultation with the National Implementation Unit of the Lao Competitiveness and Trade project, it was decided to not further pursue the investigation of this issue in preparation for the 2019 Lao Business Forum.

[2] Hong Kong, Malaysia, Philippines, Singapore, Thailand

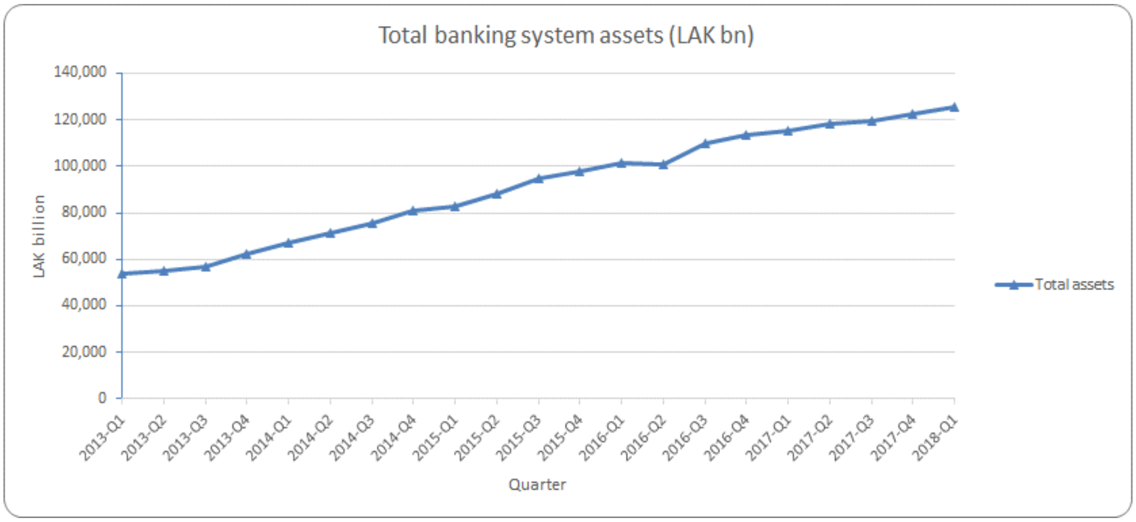
1. Interest rate cap regulations

A review was made of the Lao banking sector interest rate caps and of recent developments in interest rate cap regulations globally. The papers and studies consulted are provided in the references section at the end of this report.

1.1 The Lao banking and financial system

1.1.1 Commercial banks

The Lao banking system currently has some 37 banks of which 3 State-owned commercial banks, 1 specialized bank, 3 Joint-venture banks, 7 local privately owned banks, 9 foreign subsidiary banks and 14 foreign banks with branches.



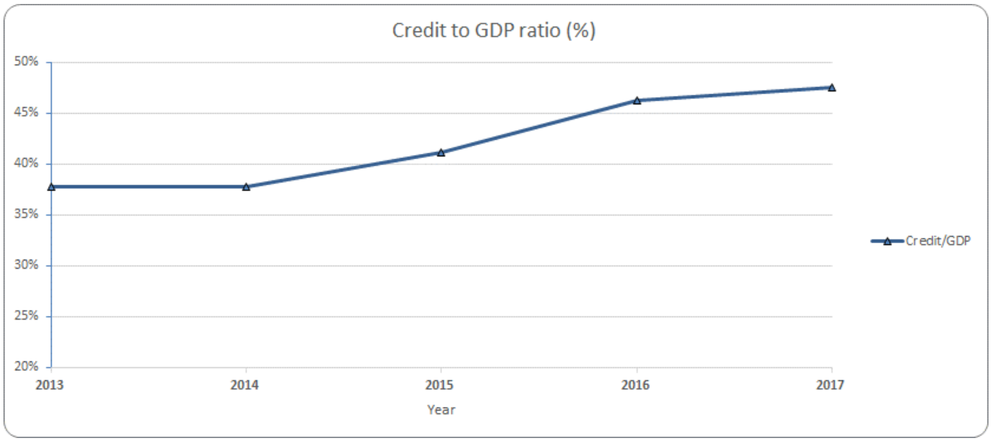
Source: Bank of Laos

Total assets of the banking system amounted to LAK 126 billion (USD 14.7 billion)[3] as of Q1/2018, with 122 branches and 514 service points. State-owned commercial banks play an important role in the sector with around 43% of total assets, including one single majority State-owned commercial bank which represents around one-third of all banking system assets and has the largest distribution network.

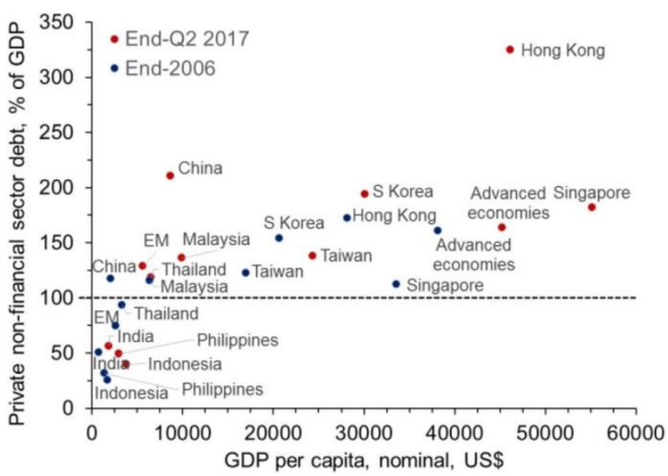
Around half the Lao adult population is estimated to be formally financially served by regulated financial institutions. With an adult population of around 4.5 million, that would imply around 2.25 million banking relationships.

[3] Exchange rate of 8520 LAK/USD

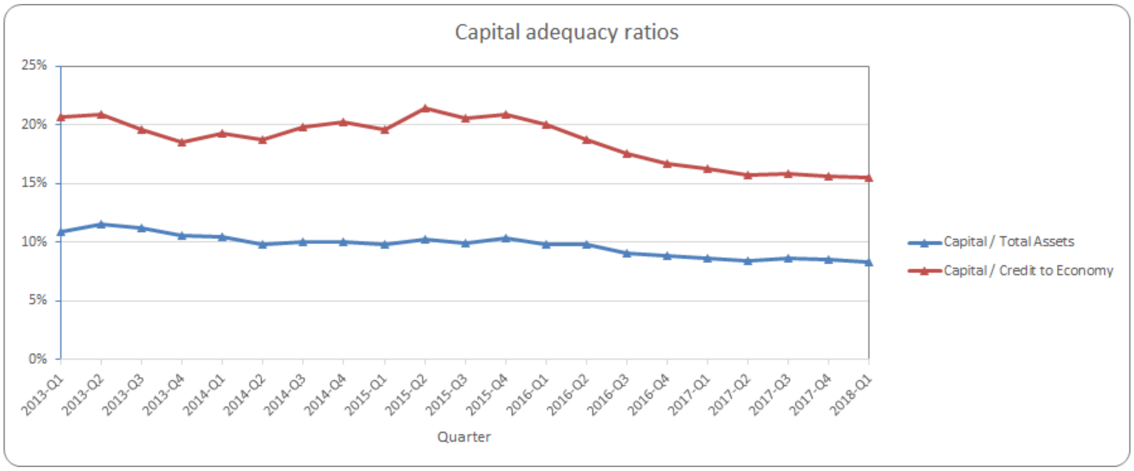
The credit to GDP ratio has increased from 38% in 2013 to 48%, but remains low by international standards and is comparable to Indonesia and the Philippines, but below that of Thailand.



Source: Bank of Laos



Sources: Oxford Economics, Bank for International Settlements, Haver Analytics



Source: Bank of Laos

The capital-to-total assets ratio (unweighted) of the banking system decreased from 10% before the introduction of the caps to 8.3% in Q1/2018. Capital-to-loans ratio (unweighted) decreased from 20% to 15.5% over the same period. Minimum paid-up bank capital requirements were raised to LAK 300 billion (USD 35 million) as from 1 January 2015.

1.1.2 Non-bank financial institutions

There are around 120 licensed microfinance institutions and savings credit unions with total assets of around LAK 750 billion (USD 90 million) and around 250,000 clients, representing less than 1% of banking sector assets/loans/deposits. Microfinance institutions and credit unions are separately regulated by the Bank of Laos and their interest rates are not subject to caps.

There is an active and fast growing commercial leasing market, while the insurance market is not well developed in Laos.

1.1.3 Financial markets

The Lao Kip is a non-convertible currency and the interbank funding market is in its infancy.

The financial sector infrastructure is not very well developed[4]. There is no national switch for domestic payments. The credit information bureau operated by the Bank of Laos is reportedly not very efficient or comprehensive. A deposit protection scheme is run by the Bank of Laos but only covers banks.

[4] Source: Lao PDR Financial Inclusion Roadmap 2016-2020 by UNCDF, published October 2016

1.2 Lao interest caps and related banking regulations

Official interest rate regulations are decided upon by the Bank of Laos (BoL) and issued by the Governor of the BoL.

The timeline of the introduction of interest rate capping and related banking regulations is described in the following timeline diagram up to the end of 2018. This is against a background of the BoL lowering its key policy rate (loans less than 1 week) on three occasions from 5% in mid-2015 to 4% currently.

Timeline of interest rate capping and related banking regulations up to the end of 2018:

	2015				2016				2017				2018			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Bank of Laos (BoL) policy rate																
LAK policy rate decisions (1 week rate)			Nr. 528/BoL of 21 July 2015, rate lowered by 50 bps to 4.5%				Nr. 676/BoL of 17 Aug 2016, rate lowered by 25 bps to 4.25%					Nr. 1230/BoL of 8 Dec 2017, rate lowered by 25 bps to 4%				
LAK interest rates																
Decisions by the BoL			Nr. 529/BoL of 21 July 2015: LAK deposit interest rate (12 m) capped at inflation rate + 2% and weighted average **lending rates 4% above**													
Instructions by the BoL			Nr. 662/BoL of 21 July 2015 on the calculation mechanics of weighted average deposit and lending rates													
Announcements													Nr. 168/BoL of 13 Jan 2018, determining 12m LAK deposit rate at 5.59%, based on previous year inflation data			
Foreign currency denominated lending																
Decisions by the BoL								Nr. 1008/BoL of 17 Nov 2016 imposing restriction on lending in FC						Nr. 422/BoL of 30 May 2018 repealing Decision 1008		
Loan related fees																
Decisions by the BoL												Nr. 1232/BoL of 8 Dec 2017 capping loan fees at max 3%				
Foreign currency interest rates																
Decisions by the BoL												Nr. 1231/BoL of 8 Dec 2017, capping the difference between average lending and deposit rates **in FC at 3%**				
Interbank interest rates																
Decisions by the BoL													Nr. 136/BoL of 5 Feb 2018 prescribing maximum interest rates on interbank deposits in LAK, THB and USD			

The original interest rate capping regulation was issued by the BoL on 21 July 2015 and the scope of application was Lao Kip (LAK). The regulation consists of **two elements:**

- LAK deposit rates are capped at the inflation rate of the previous year plus a spread. The spread for 12 months LAK deposits over the inflation rate was fixed at 2%. Maximum rates for other maturities are also fixed;
- The difference between deposit and loan interest rates on a weighted average shall not exceed 4%.

This BoL updates the underlying (previous year) inflation rate on an annual basis, most recently this was done in January 2018. The inflation rate was then determined to be 3.59% and the cap on 12 months LAK deposit rates was therefore determined at 3.59% + 2% = 5.59% and the weighted average lending rate thus 5.59% + 4% = capped at 9.59%.

In reaction to a shift in bank lending away from LAK to foreign currencies after the introduction of the LAK interest rate regulation, the BoL introduced further regulation on 17 November 2016 related to private sector lending denominated in foreign currencies. This regulation stipulated that lending in foreign currencies by banks could only take place to borrowers with revenue in foreign currency or to settle invoices in foreign currency for specific imported goods. This regulation was in effect until earlier this year, when it was repealed on 30 May 2018.

On 8 December 2017, the BoL introduced a regulation capping the weighted average between lending and deposits rates in foreign currency at 3%. At the same time, the BoL also introduced a regulation limiting loan fees to 3% of the approved loan amount.

On 5 February 2018, the BoL introduced caps on interbank interest rates for maturities from 1 week to 1 year in LAK, THB and USD.

Summary of the interest and capping regulations in force at the end of 2018:

1. LAK interest rates for current-, savings accounts and deposits are regulated and capped as a spread over the previous year's inflation rate. Interest rates for foreign currency bank funding products are not formally capped;
2. Weighted average spread between funding and lending interest rates capped at 4% for LAK;
3. Weighted average spread between funding and lending interest rates capped at 3% for foreign currency;
4. Loan commissions and fees cannot exceed 3% of the loan amount;
5. Interbank interest rates in LAK, THB and USD for 1 week to 1 year maturities are capped at between 1.5% and 3.9%;
6. BoL official reserve requirements for banks are 5% for LAK funding and 10% for foreign currency funding.

1.3 Interest rate caps: international developments

To provide international context for the study, a review was made of interest rate capping regulations in various countries.

A recent World Bank[5] study provides a comprehensive overview of interest rate caps around the world and takes stock of recent development globally. Ceilings on lending rates remain a widely used policy tool intended to lower the overall cost of credit or protect consumers from exorbitant rates.

Case studies contained in the World Bank study indicate that some forms of interest rate caps can indeed lower interest rates and help limit predatory lending practices by formal lenders, however interest rate caps often have substantial unintended side-effects. **These side-effects include increases in non-interest fees and commissions, reduced price transparency, lower credit supply and loan approval rates for small and risky borrowers, lower number of institutions and reduced branch density as well as adverse impacts on bank profitability.**

The World Bank report introduces a taxonomy of interest rate caps and classifies caps based on scope, number of ceilings, type methodology and benchmark, whether they are *binding* and whether they include fees. *Binding caps* are set at levels below market rates and used as a policy instrument to achieve certain socio-economic goals, such as lower cost of credit or a more competitive banking sector. The interest caps in Lao can be categorized as *binding caps*, as demonstrated by market evidence presented in the data collection section.

The World Bank study concludes:

Binding caps that are closely below market rates and that move with it, might exert pressure on lenders to increase efficiency and the study finds that this is especially true for markets that have high overhead costs. However, pressure on lenders can also come at the expense of brick and mortar networks which may be negative for inclusion.

Binding caps set well below market rates can reduce overall credit supply. The extent of the decline depends on the scope of the restrictions and broad restrictions can reduce overall credit supply in the economy. Blanket caps further affect the distribution of credit as they result in a particularly large decline of unsecured and small loans, as well as credit to SMEs and riskier sectors. Cases studies also point to a decline in profitability following the implementation of interest rate caps.

The World Bank study includes a number of relevant case studies of interest rate caps in developing country economies with similar credit ratings[6] to Laos, where the caps are also

[5] Interest rate caps, the theory and the practice by the World Bank's Finance, Competitiveness and Innovation Global Practice, published in April 2018

[6] Lao PDR is rated B2 by RAM Rating Services Berhad. Kenya is rated B2/stable outlook by Moody's and Zambia Caa1/stable outlook (downgraded from B3 in July 2018). WAEMU zone member countries Ivory Coast and Senegal are rated Ba3 by Moody's.

broad in application (i.e. all types of loans and banking institutions are included), and the caps are *binding* (i.e. set below market rates).

Kenya: blanket cap on all types of credit operations

The Kenyan Parliament introduced a new law on interest rate controls with the aim of reducing the cost of borrowing in September 2016. Before the implementation of the caps, real lending rates in Kenya had been high. The new law caps lending rates at 4 % above the central bank rate (CBR) and with the CBR currently at 9%, this implies a ceiling of 13% on loan rates. The law also sets a floor on term deposit rates at 70% of the CBR, effectively capping the intermediation margin at a 4% spread plus 30% of the CBR rate = 6.7% currently.

As a result of the introduction of the caps, bank lending rate dropped as most banks had to reduce lending rates to comply with the regulation. Price differentiation vanished with almost all institutions setting lending rates closely below the cap. The forced ceiling on interest rates made an already difficult lending environment even more difficult. The growth of aggregate credit to the private sector declined from 13.6% to 3.8% after the introduction of the caps. The decline in credit supply stands in contrast to the apparent increase in demand, where roughly one-third of banks state that credit demand has picked up since the introduction of the interest rate cap.

In a survey by the Central Bank of Kenya, 45% of banks stated that the interest rate caps reduced the amount of credit granted and a majority of banks reported the negative impact of caps on SME lending. The Kenya Bankers Association (KBA) also reported a sharp decline in loan disbursements, especially for unsecured personal loans, where the success rate of loan applications dropped from 50% to 34% after the introduction of the caps. The KBA further observes that as a consequence of the interest rate cap, credit is more skewed towards the secure and short-term market end. Lenders are moving away from households and SMEs that lack collateral and instead lend to the government.

Zambia: implementation and repeal of caps

The Bank of Zambia introduced interest rate caps in January 2013 with the objectives of increasing access to finance for SMEs, reducing over-indebtedness and reducing the cost of borrowing. The maximum lending rate for banks was set at a 9% margin over the policy rate of the Bank of Zambia. With the policy rate standing at 9.25% at the time of the introduction of the cap, this resulted in a ceiling of 18.25% on bank lending rates.

In November 2015, the Bank of Zambia reversed course and removed all ceilings on lending rates and allowed institutions to set rate freely. During the period that the cap was effective, credit growth in Zambia slowed substantially and the decline was especially pronounced for credit extended by MFIs which were also subject to a cap. The annual credit growth in MFI loans dropped from 63% before the implementation of the law to 38% by the time the cap was repealed.

To compensate for the lower interest rate, financial institutions started charging higher fee rates. Increases in fees were not always explicitly mentioned, making it difficult for customers with limited financial literacy to understand the full cost of the loan. Following the implementation of the caps, MFIs also tried to reduce overhead costs by increasing the average loan size and thinning out their branch networks.

Following the repeal of the cap, data suggest that lending rates started to increase, median spreads for SME loans rose and price differentiation across banks widened. In the two years since the repeal of the cap, average monthly maintenance fees dropped by about one-third. The repeal of the cap did however to change the trend of slowing credit growth which continued into 2016 as Zambia continued to struggle economically.

WAEMU*: Reduction of the interest rate ceiling

Interest rates in the WAEMU have been capped since 1997. The caps are set at absolute limits with different levels applied to banks and non-bank financial institutions, mainly MFIs. On 1 January 2014 the caps were revised downwards from 18% to 15% for banks and from 27% to 24% for MFIs.

Following the decision to reduce the rate ceiling, average lending rates declined resulting in decreasing interest rate margins for banks and the profitability of the banking sector took a hit. The aggregate level of the ratio of credit to deposits, which was rising until 2013, declined after 2013 suggesting that banks were more reluctant to extend credit. Developments in WAEMU in this period contrast to trends in the broader Sub-Saharan Africa region, where interest rate margins, profitability and credit to deposit ratios did not fall as was the case in WAEMU.

*= West African Economic and Monetary Union (WAEMU). Members of the West African Economic and Monetary Union (also known by its French acronym, UEMOA) are Benin, Burkina Faso, Cote d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal, and Togo

1.4 Regulatory impact analysis

An impact assessment was made of the Lao cap regulations on interest rates, lending to the private sector and banking system performance.

Banking sector data collection

The mission obtained aggregate banking sector and interest rate data as published monthly by the Bank of Laos on its website. We also received some high level aggregate data on banking sector capital, income and non-performing loans from the BoL. The mission also reviewed the quarterly monetary bulletins and annual report issued by the BoL.

The mission obtained selected annual reports and quarterly financial statements published by individual banks on their websites. Not all banks publish such reports regularly.

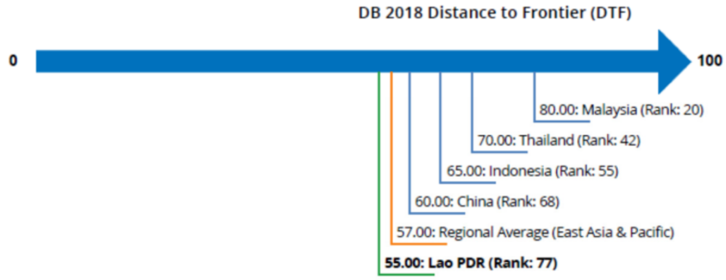
Given the limited publicly available information, the mission was not able to collect comprehensive financial performance data of the banking sector, such as evolutions of net interest margins, cost/income ratios, profitability, non-performing loan levels or capital adequacy ratios. Business performance metrics related to the number of loans in portfolio, volume of new loans approved, average size of loans, types of loans, collateral levels and acceptance rates are not disclosed by banks. This limited somewhat the scope of our analysis.

Demand side surveys

In terms of demand side surveys of access to (credit) finance in Laos, the mission reviewed two publications:

- The annual **Doing Business Survey by the World Bank** Group which compares business regulation for domestic firms in 190 economies. The study reviews a number of business indicators, including "getting credit", which refers principally to the facilitators for obtaining credit such as movable collateral laws and credit information systems and not to the availability of credit itself. In the 2018 survey, Lao was ranked 141 overall out of 191 countries on ease of doing business. On "getting credit" is was ranked higher globally (77th place), but still below the East Asia and Pacific regional average.

Figure – Getting Credit in Lao PDR and comparator economies – Ranking and DTF



Source: Ease of Doing Business Report 2018, World Bank Group

- The **Lao Enterprise Survey conducted by the World Bank**, where business owners and top managers in 368 firms were interviewed from January 2016 through June 2016. Selected survey indicators are as follows:

Lao Enterprise Survey 2016

	Lao PDR	East Asia & Pacific	All Countries
Percent of firms with a bank loan/line of credit	**12.4**	28.3	33.3
Percent of firms using banks to finance investments	**15.9**	20.5	26.2
Proportion of loans requiring collateral (%)	**96.2**	82.6	79
Percent of firms whose recent loan application was rejected	**4.3**	6.4	10.8
Percent of firms identifying access to finance as a major constraint	**5.7**	11.3	26.5

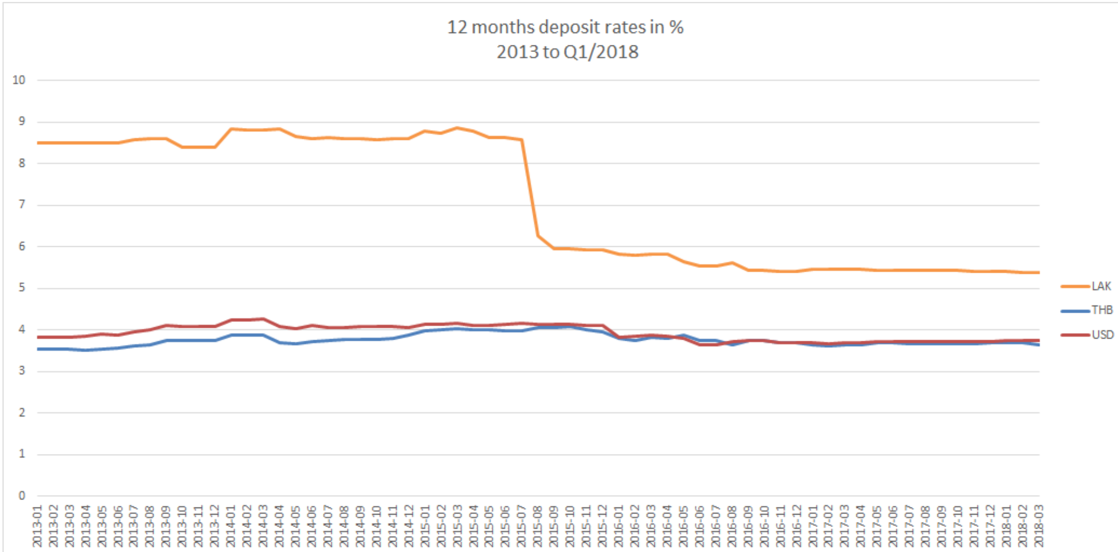
The percentage of surveyed Lao firms using banks to finance investments or with a bank loan/line of credit is only around 15% and lower than the EAP region or compared to all countries. Almost all loans seem to require collateral.

However, few firms indicate that their loan application was rejected or identifying access to finance as a major constraint, but this has to be placed in a context where working capital and investments are mainly financed internally or through suppliers.

1.4.1 Interest rate developments since the introduction of the caps

The BoL was successful in bringing down inflation and its one week policy rate was reduced in steps from 5% in mid-2015 to 4% currently.

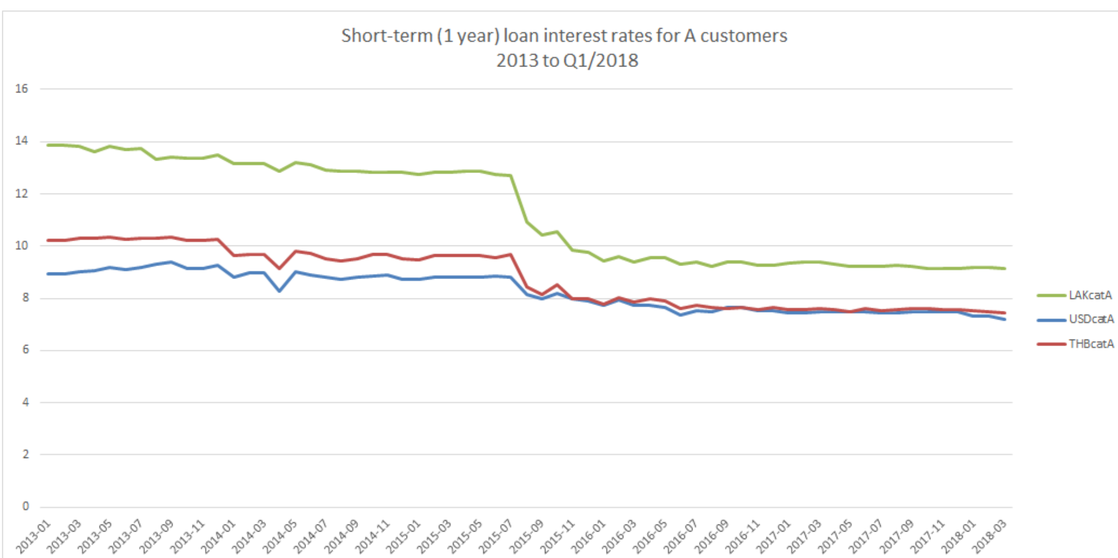
The development of banking sector average interest rates has been as follows:



Source: Bank of Laos

The introduction of the LAK interest cap on deposit rates in July 2015 had an immediate impact and brought down LAK deposit rates significantly by some 3% to below 6%. At the end of 2018, the 12 month LAK deposit average rates were situated somewhat below the cap level of 5.59% and most banks in fact were offering the capped rate of 5.59% for 12 months deposits. The cap can therefore be considered "*binding with the cap rate set well below market rates*".

USD and THB 12 months deposit rates remained stable and average around 3.7%. These rates are not capped, but a wide sectoral divergence in interest rates is observed with State-owned commercial banks paying around 3.4% for deposits, while privately owned, smaller commercial banks pay up to 6% for 12 months USD and THB deposits.



Source: Bank of Laos

Average lending rates in LAK dropped to around 9.15%, which is what most banks will charge and again situated just below the cap of 9.59%. Small interest premiums (approx. 75 bps) are generally charged for longer loan terms and less credit worthy customers. Again this cap is "*binding with cap rate set well below the market rate*".

USD and THB lending rates started dropping with the introduction of the maximum spread cap of 3% in December 2017 and can be considered "*binding*" as well.

As existing loans may have greater margins at the time of introduction of the rate caps, average rates will take some time to drop to below the cap level as pre-existing loans run-off and new business is booked under the (lower) cap regime. The fact that (higher) spreads on pre-existing loans are also counted towards the weighted average interest rate may in fact make it even more difficult to generate new lending business at attractive spreads, because these interest rates would need to be even lower to compensate the higher rates on the existing book of business.

Source: Bank of Laos

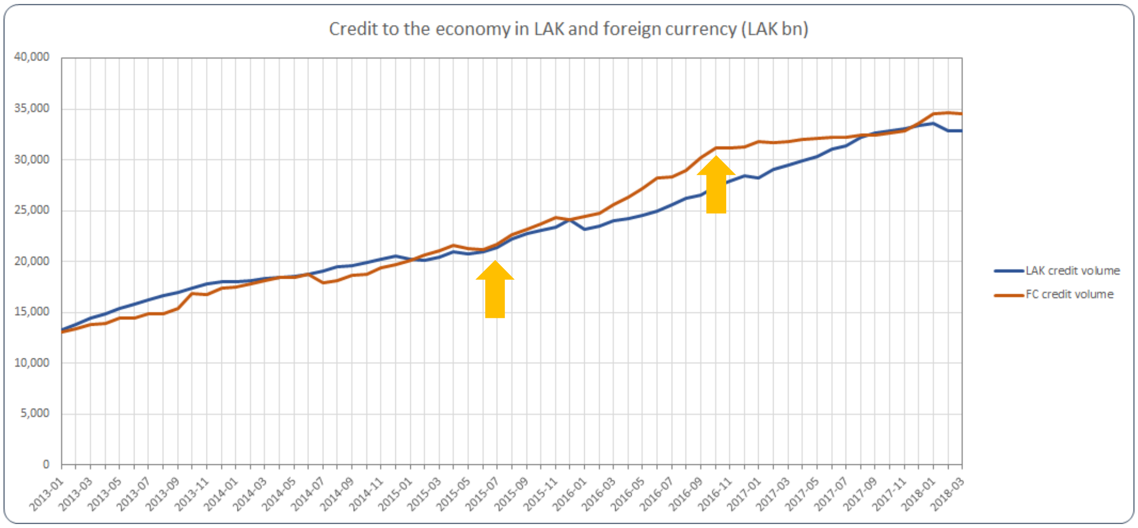
With the introduction of the ceiling of 4% on the deposit-lending average interest rate spread of 4% in July 2015, the LAK margin decreased to around 4% and has since dropped to around 3.75%.

USD and THB average margins were situated at around the same level, until the introduction of the spread ceiling of 3% in December 2017 and sector average margins were rapidly declining towards this level in 2018.

Most privately owned banks are paying higher interest rates for currency deposits than State-owned commercial banks (which are perceived as better credits) in order to attract foreign currency funding. This means private banks have a competitive disadvantage as their interest margins are further depressed when lending at the same interest rate as State-owned banks.

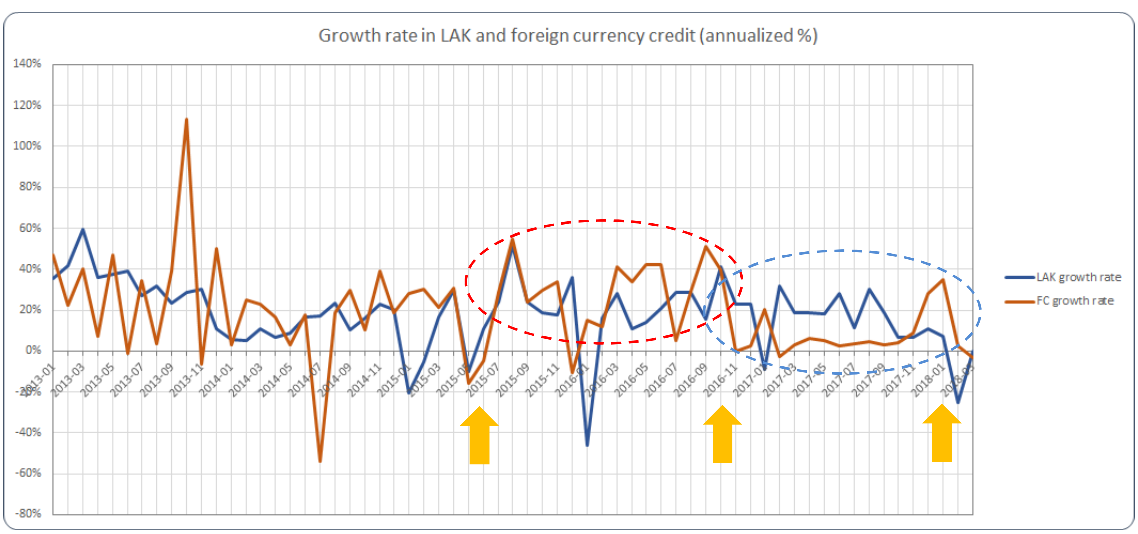
1.4.2 Credit and deposit volume trends

Analysis prepared based on the aggregate banking sector data provided by the Bank of Laos.



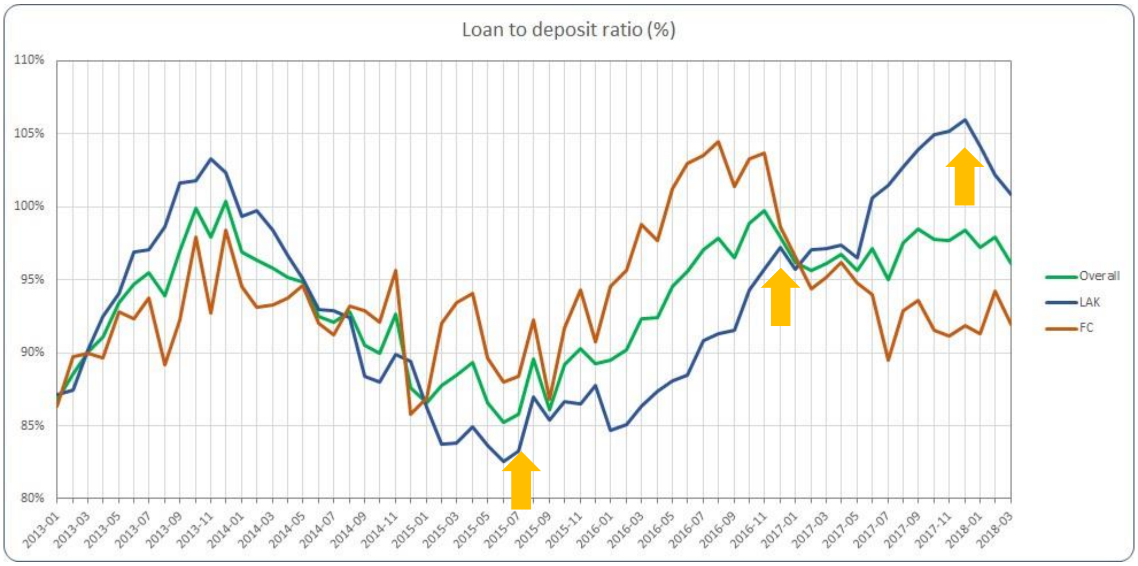
Source: Bank of Laos

Laos is a highly dollarized economy with around half the banking sector credit volume extended in the form of foreign currency, principally USD and THB. After the introduction of the LAK interest caps in July 2015, foreign currency credit volume started to exceed again LAK credit volume, rolling back the de-dollarization achievements made over previous years. The increase in foreign currency denominated lending was slowed with the introduction in November 2016 of the restrictions on foreign currency denominated lending, but this has not prevented foreign currency lending to take an increasing share of credit volume.



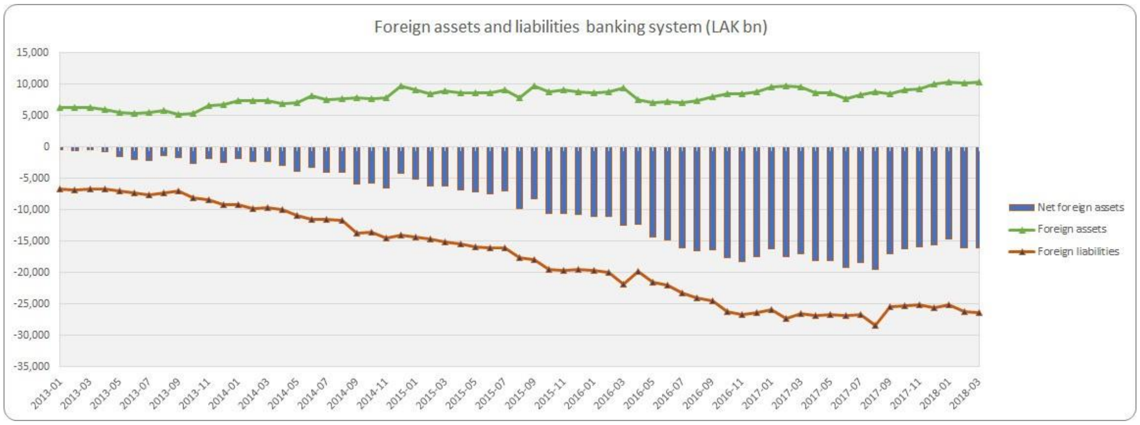
Source: Bank of Laos

After the introduction of the initial set of interest cap regulations in July 2015 and up to the introduction of the restrictions on currency lending in November 2016, currency lending was growing above trend and was higher than LAK lending. The drop in LAK lending rates in July 2015 and the increased affordability of LAK loans does not seem to have changed this. Difficulties for banks in attracting LAK funding at these lower interest rates may also have played a role. After November 2016, currency lending growth dropped significantly and with the introduction of further legislation on currency lending caps in December 2017, both currency lending and LAK lending growth has dropped further and even became negative during the first quarter of 2018.



Source: Bank of Laos

Overall, the banking sector loan-to-deposit (LTD) ratios is at a healthy level in the 90% - 100% range implying that the banking sector funding base is almost fully deployed in lending. With the introduction of the LAK caps in July 2015, LTD ratios went up, but this was much more pronounced in foreign currency, indicating a shift in lending away from LAK. With the restrictions on currency lending of November 2016, the foreign currency LTD ratio dropped sharply, while the LAK LTD ratio went up. After the introduction of the caps on foreign currency interest rates in December 2017, all LTD ratios started to drop, pointing to a contraction in lending.



Source: Bank of Laos

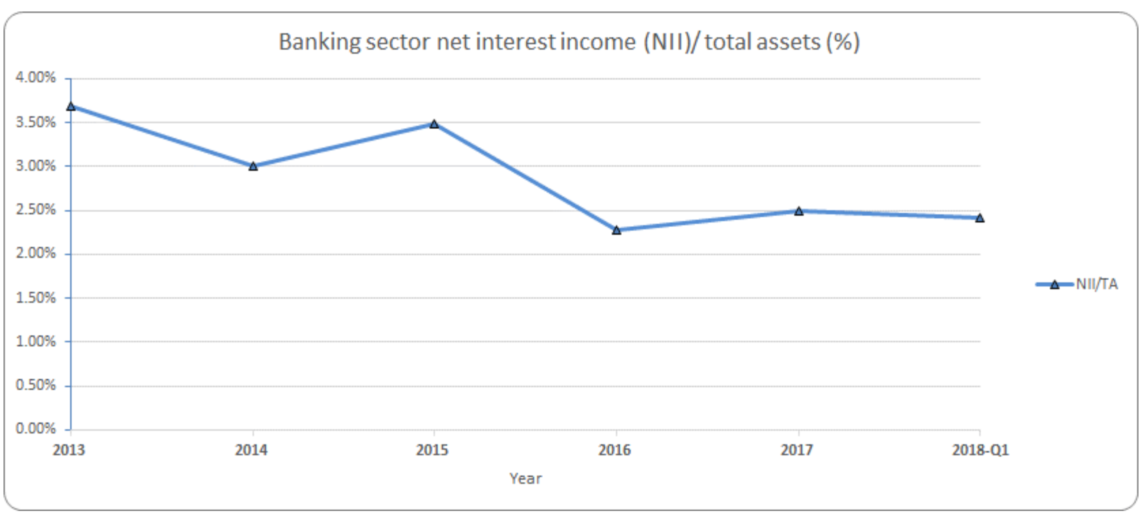
The Lao banking system has seen a build-up of foreign liabilities over the years and the sector's net foreign assets stand at LAK 15,000 billion or approximately 22% of domestic credit. Banks have increasingly relied on external (foreign & parent company) funding and the development of the LTD ratios for LAK and foreign currencies suggest that this external, foreign currency funding may have been deployed in LAK lending, implying a large open currency position in the banking system, which can pose significant risk in the absence of hedging possibilities in case of sudden depreciation of the LAK.

1.4.3 Banking sector performance

Limited aggregate data on banking sector performance was provided by the Bank of Laos. As previously mentioned, we have not been able to obtain comprehensive financial and lending performance indicators of individual banks.

Anecdotal evidence and individual bank (quarterly) performance reports support some of the inferences that can be made from sectoral aggregate data.

Profitability



Source: Bank of Laos

Net interest income / total assets for the banking sector as a whole has been declining with the introduction of the first interest rate caps in 2015. The NII/total assets ratio is currently around 2.5%. Along with fee & commission income (which is typically less than 20% of a Lao bank's gross income) this should cover operating costs, reserve requirements, taxes and cost of risk (non-performing loans) in order to achieve an adequate return on capital and maintain growth supportive CARs. A NII spread of 2.5% is not a particularly high spread in an economic and credit quality environment such as Lao (with a sovereign rated non-investment grade B2), as can be seen from the table below:

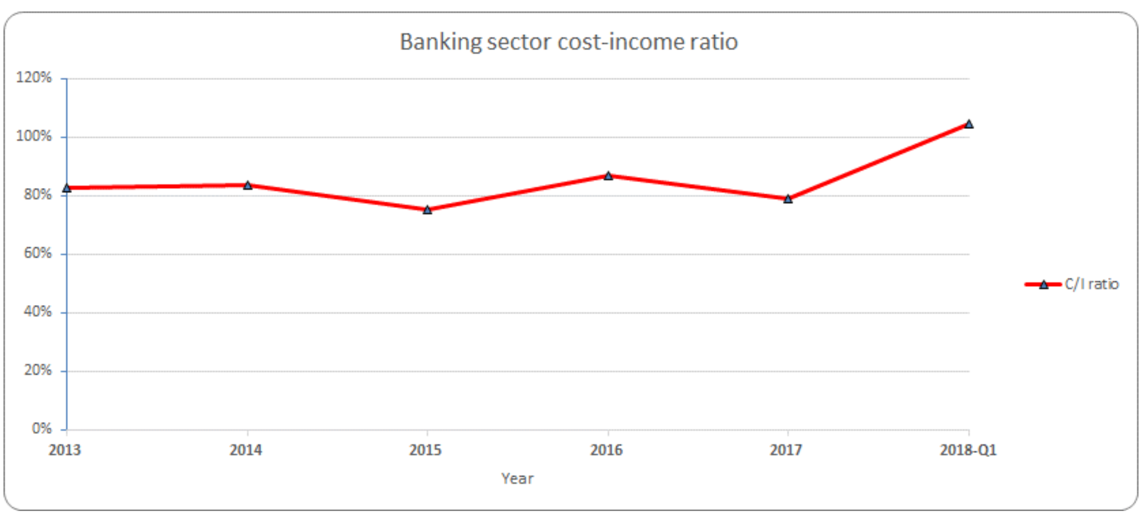
Table 1: Interest Rate Spreads across Countries and Regions

	2000	2004	2008	2009	2011	2012	2013	2014	2015	2016
Angola	6.4	6.7	6.0	8.1	12.4	13.1	12.7	12.9	13.6	10.2
Botswana	6.1	5.9	7.9	6.3	5.9	7.4	7.1	6.5	5.4	5.2
Algeria	2.5	4.4	6.3	6.3	6.3	6.3	6.3	6.3	6.3	6.3
Egypt. Arab Rep.	3.8	5.7	5.7	5.5	4.3	4.4	4.6	4.8	4.7	5.7
Kenya	**14.2**	**10.1**	**9.5**	**9.7**	**10.8**	**12.0**	**10.8**	**9.9**	**9.2**	**9.5**
Mauritius	11.2	12.9	1.4	0.8	1.8	2.4	1.7	1.7	2.4	3.3
Namibia	7.9	5.0	5.4	4.9	4.4	4.4	4.3	4.5	4.6	4.2
Nigeria	9.6	5.5	3.5	5.1	10.3	8.4	8.8	7.2	7.7	9.4
South Africa	5.3	4.7	3.5	3.2	3.3	3.3	3.3	3.3	3.3	3.3
World	7.4	6.0	5.7	5.7	5.8	5.4	5.8	5.5	5.3	5.5
East Asia and Pacific	5.0	5.4	4.6	5.0	5.0	5.0	5.0	4.9	5.0	4.8
Sub-Saharan Africa	13.6	12.9	6.7	6.7	8.0	7.1	7.1	7.2	6.8	6.1

Source: World Bank

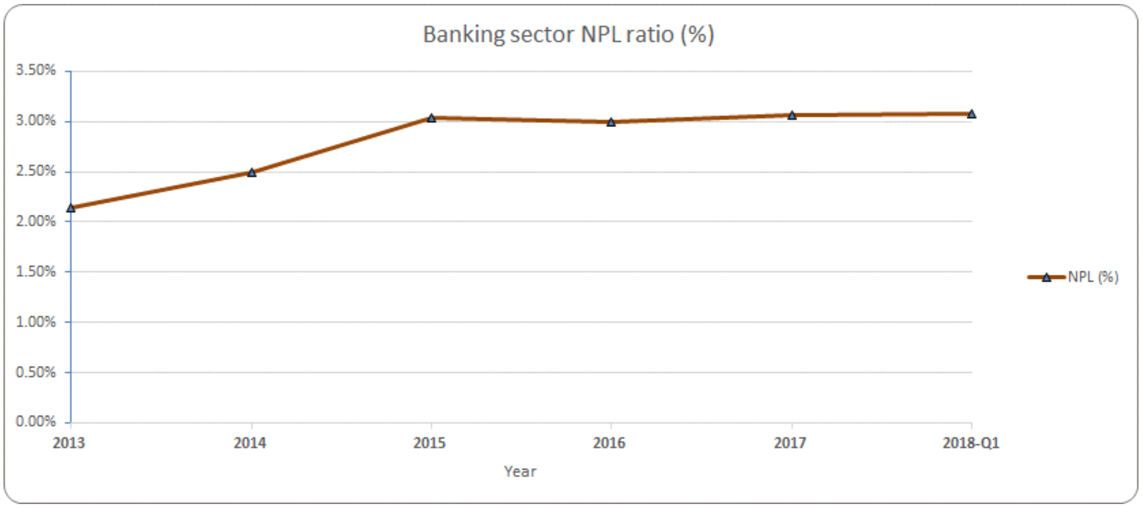
According to the high-level data received from the BoL, the overall Lao banking system cost-to-income ratio seems around 80%, having even gone above 100% earlier in 2018, which would imply a banking sector that is not covering cost.

Best practice international bank C/I ratios are situated between 40% and 60%. A C/I ratio of 80% leaves little room for further network expansion, absorption of the cost of risk (non-performing loans) and capital formation to support a growing business.



Source: Bank of Laos

BoL data indicate a stable NPL (non-performing loan) ratio of around 3% for the banking sector, which is not particularly elevated by international standards. However, as noted in the recent Lao Economic Monitor Report of June 2018 by the World Bank[7], 4 of the 14 banks that published their 2017 annual reports as of Q1/2018 reported NPL ratios in excess of 10%, and this is while most banks that publish statement according to IFRS do not yet apply the latest IFRS 9 standard on loan impairment. The true level of NPLs of the banking sector may therefore be understated and current levels of interest rate margins (4% in LAK and 3% in foreign currency) may not be adequate to absorb the cost of risk.



Source: Bank of Laos

[7] Lao PDR Economic Monitor, June 2018 by the World Bank Group, page 28

1.5 Conclusions impact analysis

Evidence from the impact of the cap regulations points to the following conclusions:

- **Increased regulatory compliance burden and administrative cost**: Since 2015, the BoL has introduced eight different (and changing) interest rate capping and lending regulations that are complex to implement and maintain by banks. These regulations and their detailed prescriptions and calculation mechanisms impose significant additional regulatory compliance costs and administrative operating costs on banks;

- **Introduction of interest caps has led to a slowdown in lending**: Lao caps are set well below market rates and are *binding*, as evidenced by the drop in interest rate and interest rate spreads upon the introduction of the various cap regulations. Although the policy goal of lowering interest rates was met and loan affordability increased, evidence from market behaviour indicates that it has led to a contraction in lending or at least a slowdown in credit growth. This notwithstanding the presence of a very large number of banks for an economy the size of Laos.

  The slowdown in lending was particularly evident after the introduction of the LAK caps in July 2015 with the shift to foreign currency lending and again after the introduction of the foreign currency deposit-lending spread cap of 3% in December 2017. The 2016 Lao Enterprise Survey conducted by the World Bank shows that the percentage of firms that have a bank loan or use banks to finance remains very low compared to the East-Asia & Pacific (EAP) region;

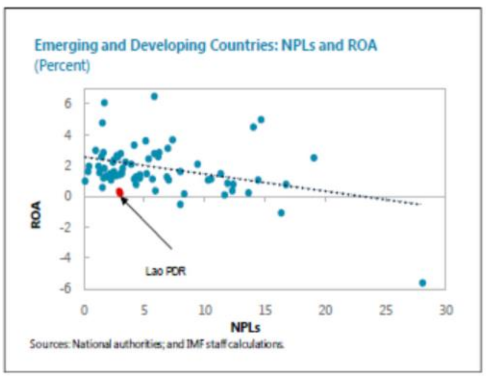
- **Interest cap levels are seen as very constraining**: A weighted average borrowing-lending spread capped at 4% in LAK and 3% in foreign currencies is too low for banks to operate profitably in the institutional and risk context of the Lao economy, for a number of reasons:

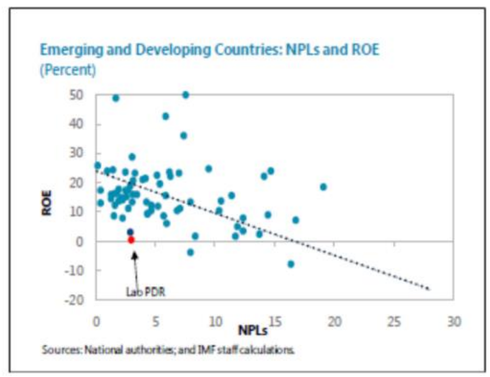
  - Lao PDR (the sovereign, which is normally considered the best credit in the domestic market) has a non-investment grade credit rating of single B defined by credit rating agencies as "speculative and subject to high credit risk". As illustration: The credit spread on THB bonds issued by Laos over the Thai sovereign (rated investment grade Baa1 by Moody's) in October 2017 was 2.5% to 3.5% (in 5 to 15 year maturity). All other Lao private sector borrowers (companies, agencies, individuals) would normally be expected to pay higher credit spreads to compensate for higher cost of risk. Taking into account such (minimum) cost of risk, a bank lending margin of 3% to 4% therefore does not leave much room to cover a bank's operating cost, regulatory reserve requirements, taxes and generate a profit, except when lending to the Government itself;
  - In the 2018 Ease of Doing Business Survey, Lao was ranked 141 out of 191 countries on overall ease of doing business score and below its EAP peers.

The Lao institutional and business environment imposes significant additional operating cost on banks in terms of credit risk assessment, monitoring of borrowers' performance and recovery of non-performing loans, which is higher than in many other countries;

- Compared to other similar economic environments, the Lao caps are seen as very constraining. For example in the WAEMU[8] zone, where the currency is effectively tied to the Euro, bank interest rates are capped at 15%, MFIs are capped at 24% and there are no caps on deposit rates. The lending caps introduced for MFIs in neighbouring Cambodia in March 2017 are situated at 18%, which is 2.5% below the average lending rate charged by commercial banks[9]. The Kenya intermediation margin is capped at 6.7% currently.

- **Impact on banking sector prudential risk**: The inability of banks to generate an appropriate margin and generate an adequate ROA and ROE will impact banks' ability to maintain and build an adequate capital position and risk absorption cushion, ultimately posing a systemic risk. Return on Assets (RoA) and Return on Equity (RoE) of the Lao banking sector is low by international standards:





Source: IMF 2016 Article IV Consultation Staff Report on Lao, February 2017. RoA = return on assets, RoE = return on equity

- **Distortions in the funding market**: Since the introduction of the LAK caps on deposit rates, all banks were essentially paying the same (capped) interest rates which has eliminated price competition for deposit mobilization. With State-owned banks being perceived as better credits by the market than privately operated banks and with everything else being equal, the State-owned banks have actually benefited in terms of funding mobilization at the expense of smaller and privately owned banks. There are indications that limited access to LAK funding has constrained lending by privately owned banks. The interbank money market would normally act as a funding channel between banks, but this market is not well developed in Laos and is also subject to capped regulation;

[8] WAEMU = West African Economic and Monetary Union
[9] Page 27, Interest rate caps: the theory and the practice, policy research working paper by the World Bank's finance, competitiveness and innovation global practice, April 2018

- **Re-dollarization**: The shift in LAK lending to foreign currency denominated lending after the introduction of the LAK caps has led to re-dollarization and rolled back some of the achievements made by the BoL over the previous years in de-dollarization;

- **Build-up of potentially harmful open foreign exchange position**: The increase of the banking sector's net foreign liability position since 2015 and the divergence in the development of the loan-to-deposit ratio in LAK and in foreign currency (with the LAK ratio increasing and the foreign currency ratio decreasing) point to the build-up of a significant open currency position in the banking system, where banks are funding LAK lending with foreign currency funding. The LAK being non-convertible and in the absence of foreign exchange hedges, this could pose a systemic risk in case of a sudden depreciation of the LAK. In its Article IV Consultation Reports, the IMF has pointed out on several occasions that it considers the LAK significantly overvalued – estimated at some 30% [10];

- **Potential for lending to shift to unregulated or lightly regulated providers:** Only Lao banks are subject to the cap regulations. The microfinance sector and leasing companies are not subject to interest caps. Experience with interest caps in the WAEMU zone, where banks are capped at 15% at MFIs at 24%, has shown that higher risk lending is shifting from banks to more lightly regulated deposit taking MFIs. There are also instances where banking and financial groups create MFI structures to conduct higher risk lending business.

[10] Page 6, IMF staff report for the 2016 Lao PDR Article IV consultation, February 2017 and the IMF staff report for the 2017 Lao PDR Article IV consultation, March 2018

1.6 Findings from the field mission

The purpose of the field mission was to follow-up on the initial impact analysis completed in October 2018 and receive feedback from the sector on the draft technical paper produced and circulated at the time.

A field mission took place in April-May 2019 in which interview meetings were held with a total of ten different banks: One State-owned commercial bank, three joint-venture banks, one locally owned bank, four foreign owned banks and one foreign bank branch, a leasing company and a fintech company (see Annex for full meeting schedule).

In addition, financial sector stakeholders were also met, including the Lao Bankers Association, the Microfinance Association, the National Implementation Unit at the Ministry of Industry and Commerce and the World Bank's Access to Finance Program (at DOSMEP).

During the field mission, we found that on 12 February 2019, the Bank of Laos issued, with immediate effect, a repeal of all interest rate cap regulations through Agreement 140/BoL, (see Annex), specifically:

- Regulation 529/BoL from 21 July 2015 on LAK deposit interest rates and average borrowing-lending interest rates for banks
- Regulation 1231/BoL from 8 December 2017 capping the difference between average lending and deposit rates in foreign currencies

From 12 February 2019 onwards, banks were free to set market based interest rates for deposit taking and lending. However, prior to making significant changes in interest rates, a bank should request approval from the Bank of Laos. Banks should report their deposit and lending interest rates regularly as per instruction 96/MPD from 22 January 2019. Interest rates should not be set at a predatory level to address issues related to non-performing loans, which should not exceed 3% of the loan portfolio.

During the mission's interview meetings in April-May 2019, banks confirmed that:

- The 140/BoL repeal agreement had been communicated to them by the Bank of Laos on 12 February 2019 in the Lao language. It took some time for the sector to interpret the new agreement (have it translated in some cases) and obtain clarifications for the Bank of Laos
- All banks expressed satisfaction that the cap regulations have now been removed, allowing them to determine and set their own market based and competitive interest rates
- It is the banks understanding that only in case of major and sudden changes in interest rates (3% to 5% was mentioned), they would need to ask explicit prior approval from the Bank of Laos. In cases of smaller incremental changes, they can freely decide to change their interest rates, as long as they comply with the regular interest rates reporting requirements as specified in instruction 95/MPD

- One bank already decided to raise its 12 month LAK deposit rate by 1% from 5.59% (previously capped level) to 6.59% in order to attract more LAK funding to fulfil lending demand. Other banks take a wait-and-see approach, keeping a watchful eye on any decisions on interest rates by the market leader – BCEL. One bank mentioned that they expect some interbank funding rates to increase soon

Potential impact of the interest rate cap repeal going forward

- The repeal of interest rate caps should stimulate the availability of credit as banks can now charge appropriate interest rates and margins to cover the cost of risk of lending to the private sector in the Lao economic environment

- Banks now have added flexibility for risk based pricing of lending rates, which should improve access to finance for (higher-risk) small and medium sized enterprises

- Privately owned commercial banks are now in a better position to attract funding as they can now compete with State owned commercial banks by offering more attractive deposit rates. Privately owned banks are perceived as riskier credits than State owned banks

- Over the medium term, improved interest rate margins should address banking sector profitability issues (low RoA and RoE in Laos) and allow banks to invest in growing their business footprint, customer service and network outreach

- Repeal of the cap regulations lessens the regulatory reporting and administrative burden placed on banks, allowing cost savings and banks to improve their (high) cost-income ratios

- Banks can now compete on interest rates again with microfinance institutions and leasing companies that had not previously been subject to the interest rate cap regulations

2. Taxation of unrealized foreign exchange gains and losses

2.1 Background

Description of the issue: Assertion by the Lao Bankers Association

During one of the 2018 Lao Business Forum financial sector working group meetings, the Lao Banking Association raised the issue that gains from foreign exchange movement on account closing date (unrealized gains) were treated as taxable earnings. Commercial banks argued that unrealized gains should not be subject to taxation because these gains are only on paper while no actual transactions ever take place. In this regard, the banking sector proposed that the Government should consider treating unrealized gains as non-taxable income. The concern was that as the foreign currency deposits account for 52% of total deposits (Bank of Laos annual report 2016), imposing tax on unrealized gains incurs costs for commercial banks which could lead to higher borrowing costs thus causing a negative effect on credit access.

2.2 Corporate profit taxation in Lao

Corporate profit taxation in Lao is governed by Articles 26 - 42 of the 2012 Tax Law[11]. Corporate profit tax calculation closely follows accounting profits, prepared in accordance with the Lao Accounting Manual, as adjusted for tax purposes[12].

The Lao tax regulations are silent on the treatment of a large number of items, including the treatment of unrealized foreign exchange gains and losses.

Tax treatment of unrealized gains and losses

It is a well-established principle of taxation that gains or losses are recognized for tax purposes only when they are realized. Thus, revenue foreign exchange differences are taxable or deductible only when they are realized. Several publications would indicate that this is also the case under Lao corporate profit taxation:

- The worldwide tax summaries, corporate taxes 2016/17, publication by PwC, June 2018 states on page 191: "Unrealized exchange gains are not taxable and losses are not deductible in Lao PDR";
- The Laos tax booklet, published by VDB Loi in June 2016, states on page 15 and 16 that unrealized foreign exchange losses are non-deductible expenses and unrealized foreign exchange gains are non-taxable income.

[11] The Lao Accounting Manual and Accounting Law are currently under review and being brought in closer alignment with International Financial Reporting Standards (IFRS)
[12] Source: PwC Laos website, last reviewed 18 December 2017

2.3 Taxation in other regional jurisdictions

A review of the tax treatment of unrealized foreign exchange gains or losses in other regional jurisdictions confirms that revenue from foreign exchange differences are taxable or deductible only when they are realized.

Hong Kong

Page 80 of the PwC worldwide tax summaries, corporate taxes 2016/17, by PwC, June 2018 states that "In general, unrealized exchange gains/losses are taxable/deductible if they are recognised in the profit and loss accounts in accordance with Generally Accepted Accounting Principles, provided that they are revenue in nature and with a Hong Kong source. The nature and source of the exchange gains/losses are determined by the nature and sources of the underlying transactions. Exchange gains/losses arising from ordinary business transactions (e.g. trade receivables or payables) are taxable/deductible whereas exchange gains/losses arising from capital transactions (e.g. sale of capital assets) are non-taxable/ non-deductible." Unrealized foreign exchange gains/losses on monetary (capital) transactions (financial assets and liabilities, such as funding and lending transactions) therefore not seem to be subject to taxation.

Malaysia

Section 3.1 of the Guidelines on the tax treatment related to the implementation of Malaysian Financial Reporting Standard (MFRS) 121 (or other similar standards), issued by the Inland Revenue Board of Malaysia in July 2015 state "In principle, gain or loss on foreign exchange which is revenue in nature is taxable or deductible when it is realized".

Section 3.5.3 of the Guidelines state "When foreign currency denominated transaction is translated into functional currency and functional currency to Malaysian Ringgit, any difference will be treated as translation gains or losses. The translation of gains or losses will neither be taxable as income nor deductible as tax deduction".

Singapore

The updated IRAS e-tax guide on Income tax treatment of foreign exchange gains or losses for business, Inland Revenue Authority of Singapore, 29 June 2012, refers to the earlier e-tax guide published on 28 November 2003, which states "the revenue from foreign exchange differences are only taxable or deductible for income tax purposes when they are realized".

Thailand

An article published in The Nation, contributed by KPMG, on the adoption of foreign currency in computing Thai income tax, on 5 September 2017, states that where the foreign functional currency (FFC) computation has been adopted, foreign exchange gains and losses arising from the FFC application will not be taxable or deductible.

The Philippines

In a website article on accounting and tax differences in the Philippines, published by PwC on 23 March 2018 on filing company income tax returns states "Gains and losses: Gains are recognized in the period earned, and losses are recognized in the period incurred …… For purposes of taxability of gains and deductibility of losses, only realized gains and losses during the period are taxable and deductible. Therefore, companies should be able tp monitor actual and realized gains and losses of the company's transactions. For example, foreign currency exchange gains/losses from collection of receivables and payment of liabilities are considered realized and are considered taxable gains/deductible losses since they are considered completed transactions, but foreign exchange gains/losses resulting from year-end conversions of foreign currency denominated receivables and payables are considered unrealized gains/losses and should be treated as a temporary tax difference".

2.4 Impact assessment

Exchange rate movements potentially have a significant impact on bank taxation. As can be seen in the graph on page 22, the Lao banking system has a large overall net foreign liability position, which has grown significantly since 2013. Under the assumption that the foreign liability position is 50% USD denominated and 50% in THB (the most commonly used foreign currencies in Laos) and mostly deployed in LAK lending and assets (see page 24) the potential FX revaluation gains or losses for the entire banking sector during the period 2014 to 2017 are shown in the table below. The overall sector would have had a large FX revaluation gain in 2015 when the THB weakened against the LAK and a large FX revaluation loss in 2017 when the THB strengthened against the LAK. Of course this impact analysis is high-level and general in nature, as it concerns the overall banking system and there may be big variations in positions between individual banks. Also, the analysis assumes that foreign currency open positions are static and the analysis is not able to distinguish between realized and unrealized gains or losses.

Banking system overall foreign asset & liabilities position

	2012	2013	2014	2015	2016	2017
Year-end net foreign liabilities (LAK bn)	624	-2,421	-4,195	-10,633	-17,388	-15,608
Average during the year (LAK bn)		-899	-3,308	-7,414	-14,010	-16,498
Assumption 50/50 USD and THB						
Average USD liability		-449	-1,654	-3,707	-7,005	-8,249
Average THB liability		-449	-1,654	-3,707	-7,005	-8,249
LAKUSD rate (year-end)	7947	8017	8100	8150	8168	8316
Change during the year (%)		0.88%	1.04%	0.62%	0.22%	1.81%
LAKTHB rate (year-end)	260	243	246	226	228	255
Change during the year (%)		-6.54%	1.23%	-8.13%	0.88%	11.84%
USD revaluation gain or loss (LAK bn)		-4	-17	-23	-15	-149
THB revaluation gain or loss (LAK bn)		29	-20	301	-62	-977
Total FX revaluation gain or loss (LAK bn)		**25**	**-38**	**279**	**-77**	**-1,126**
Corporate tax rate = 24%						
Taxes due/offset (LAK bn)		6	-9	67	-19	-270
Taxes paid by all banks (LAK bn)			103	105	72	318
FX gain or loss taxation/total taxes paid (%)			8.7%	63.5%	25.8%	85.0%

Source: Bank of Laos

The high-level impact analysis show that FX revaluation gains or losses are significant in the banking sector given the large externally financed position deployed in LAK lending & assets.

Swings in foreign exchange rates will therefore create significant revaluation gains and losses. At this stage we cannot determine whether these are realized (and thus potentially taxable or deductible) or unrealized and according to above publications should not be subject to taxation.

The tax impact of foreign exchange revaluations for the Lao banking sector under the above scenario could potentially be up to 65% to 85% of all taxes paid by the entire banking system in a given year. The impact of the treatment of foreign exchange gains or losses on bank taxation is therefore significant.

2.5 Conclusions

The large net foreign liability position of the Lao banking system (approx. LAK 16,000 billion or approximately 22% of domestic credit) and the widespread use of foreign currencies in the domestic market ("dollarization"), has the potential to create a significant foreign exchange (re-) valuation results in LAK. The tax impact of foreign exchange revaluations for the Lao banking sector could potentially be up to 65% to 85% of all taxes paid by the entire banking system in a given year.

Although in accounting terms, realized and unrealized foreign exchange gains or losses are included in the profit and loss account for the period, it is a well-established principle of taxation that gains or losses are recognized for tax purposes only when they are realized. Thus, revenue foreign exchange differences should be taxable or deductible only when they are realized. Several publications by tax advisors would confirm that this is also the practice followed in Laos. Tax authorities in other regional jurisdictions also follow this principle.

2.6 Findings of the field mission

The purpose of the field mission in April-May 2019, was to clarify the assertion made by the Lao Bankers Association that gains from foreign exchange movement on account closing date (unrealized gains) are treated as taxable earnings.

A meeting was held with the Lao Bankers Association on 22 April 2019 in which they were not able to further clarify their earlier assertion made in 2018. In subsequent meetings with some ten different commercial banks (see meeting schedule contained in Annex), none of the banks raised concerns with the tax treatment of unrealized foreign exchange gains and losses. Upon consultation with the National Implementation Unit of the Lao Competitiveness and Trade project, it was decided to not further pursue the investigation of this issue in preparation for the 2019 Lao Business Forum.

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	IRAS e-tax guide, Income tax treatment of foreign exchange gains or losses for business, Inland Revenue Authority of Singapore, 29 June 2012
	Accounting and tax differences in the Philippines, PwC, 23 March 2018

Annex: Field mission meetings

Schedule of field mission meetings in April-May 2019:

Date	Party	Participants
22 April	Ministry of Industry and Commerce, NIU	Mr. Sengxay Phousinghoa, Private Sector Development Advisor Ms. Thipphaphone Vongsay, Senior Trade Analyst
	Lao National Chamber of Commerce and Industry (LNCCI) / A2F SME training project	Mr. Phouxay Thepphavong, Secretary General Mr. Somsay Ouanphilalay, LNCCI Ms. Daovading Phirasayphithak, Deputy Secretary General Ms. Dalaphone Sengdavong, Private Sector Development Consultant Mr. Sauli Hurri, ILO Chief Technical Advisor
	Lao Bankers Association	Ms. Sengdavone Bangonsengdet, Secretary General
23 April	Lao China National Bank (LCNB)	Mr. Bounlath Southisack, Vice President Mr. Orathay Nounouannavong, Marketing Dept
	ACLEDA Bank Lao	Dr. Hay Svay, CEO Mr. Outo Saechow, Head of Treasury Department
	BCEL	Mr. Somphorn Houngnachith, Deputy Chief of Treasury and International Services Mr. Soule Bounmixay, Head of Credit Admin Ms. Soukthada Sennam, Deputy Treasury Section
	Sacom Bank	Ms. Oulayphone Songeun, Deputy General Director
24 April	LaoViet Bank	Mr. Pham Quoc Cong, Deputy General Director Mr. Anousith Xayalath, Deputy Chief of Treasury
	ANZ Bank Lao	Mr. Sophy Keo, COO Mr. Aekananh Keosouvath, Senior Relationship Mgr Ms. Somvone Siaphay, Head of Compliance & AML
	SME Access to Finance (A2F) / DOSMEP	Mr. Kingxay Chounlamountry, Director of Division Mr. Sith Soukchaleunphone, A2F Manager
	ST Bank	Mr. Souchinda Chanthachack, Manager of Services Department + team
25 April	Banque Franco Lao (BFL)	Mr. Arnaud Caulier, CEO
	UNCDF	Mr. Cédric Javary, Chief Technical Advisor, Inclusive Finance
26 April	Bangkok Bank, Lao branch	Ms. Chadaphorn Uratchat, Branch Manager Ms. Manivone Siharath, Treasury Officer Mr. Aphixay Phoumavong, Credit Marketing Dept Ms. Viphavady Meksithong, Compliance Dept
	Krungsri Leasing Services Company	Mr. Viboon Jirapatanakul, Managing Director Mr. Nattawut Thonnaratana, CFO
	RHB Bank Lao	Ms. Souphaphone Souannavong, Head of Business Development and Marketing Ms. Duangchai Chithsavath, Business Development

Date	Party	Participants
		and Marketing
29 April	World Bank / IFC	Mr. Mombert Hoppe, Senior Trade Economist and LCT Task Leader Ms. Vidaovanh Phounvixay, Financial Sector Analyst Ms. Vonglatda Omany, Senior Financial Sector Specialist IFC
30 April	Ministry of Industry and Commerce, NIU	Mr. Sengxay Phousinghoa, Private Sector Development Advisor Mr. Somsay Ouanphilalay, LNCCI Ms. Dalaphone Sengdavong, Private Sector Development Consultant, LNCCI
3 May	Lao Microfinance Association	Mr. Somphone Sisenglath, Chairman of the Board of Directors Ms. Pamouane Phetthany, Executive Director
	Lao National Chamber of Commerce and Industry (LNCCI) / A2F SME training project	Mr. Phouxay Thepphavong, Secretary General Mr. Somsay Ouanphilalay, LNCCI Ms. Anjali Patel, ILO Enterprise Training Officer Ms. Hatthakone Sengsouliyachan, ILO National Project Coordinator
9 May	Payplus Fintech Co. Ltd.	Mr. Lukasz Nitka, COO

Annex: Agreement 140/BoL

Agreement on the repeal of the interest rate cap regulations issued by the Bank of Laos on 12 February 2019:

ສາທາລະນະລັດ ປະຊາທິປະໄຕ ປະຊາຊົນລາວ

ສັນຕິພາບ ເອກະລາດ ປະຊາທິປະໄຕ ເອກະພາບ ວັດທະນະຖາວອນ

Bank of Lao PDR

No 140/BoL

ນະຄອນຫລວງວຽງຈັນ, ວັນທີ 12 ກຸມພາ 2019

ຂໍ້ຕົກລົງ Agreement

On the Determination of commercial banks' interest rates

-Pursuant to the Law on Bank of Lao PDR
-Pursuant to the Agreement on the Determination of Commercial Banks' Interest rates no 529/ BoL dated 21 July 2015
-Pursuant to the Agreement on the Determination of the Difference between weighted average deposit rates and lending rates for foreign currencies of commercial banks no 1231/BoL dated 8 December 2017

ເງິນຕາຕ່າງປະເທດຂອງທະນາຄານທຸລະກິດ ສະບັບເລກທີ 1231/ທຫລ, ລົງວັນທີ 08 ທັນວາ 2017.

The BoL Governor hereby agrees the following

Article 1 Commercial banks are allowed to determine interest rates for deposit-lending in accordance with the market mechanism which is managed by the state as follows:

1. Deposit interest rates:
- Commercial banks shall determine the deposit rates suitable for the economic conditions and cost management of their own business operation principles.
- Commercial banks shall not determine the deposit rates in predatory manner to fix short-term cash flow issue and the problem of NPL exceeding 3%, in order to distort or dump the market.
- Commercial banks shall establish transparency in providing services to clients by publishing the information on interest rates for deposit and lending schemes, terms and conditions, and related fees through various channel such as announcement, notice board, or banks' website;
- Commercial banks are not allowed to create unrealistic promotion or campaign to attract depositors

ເວັບໄຊຣ໌ຂອງທະນາຄານຕົນ;

– ບໍ່ອະນຸຍາດໃຫ້ທະນາຄານທຸລະກິດໂຄສະນາລະດົມທຶນ ຫຼື ໂຄສະນາດຶງດູດລູກຄ້າເກີນຄວາມເປັນຈິງ.

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2 2. Lending rates:
- Commercial banks shall determine lending rates in accordance with the capital management principle and risk of individual customers that are deemed fair for both parties;
-Commercial banks shall not determine the lending rates that are deemed coercive or disadvantageous to customers

Article 2 Reporting

ມາດຕາ 2 1. Prior to making significant change in the interest rates for both deposit and lending, commercial banks shall inform BoL for authorization;

1. 2. Commercial banks shall update/report the interest rates in accordance with previous announcement (Announcement on the launch of information reporting system for deposit-lending rates of commercial banks no 96/MPD, dated 22 January 2019).

2.

Article 3 Violation

1. Violation of the determination of deposit rates as written this agreement shall face with following measures:

ມາດຕາ 3 - violator shall receive a written warning for the first violation and must comply within 1 day

1 - if violation persists after first warning, a fine of LAK 5 million per day shall be made;
- if fined for 30 days consecutively without compliance, suspension or restriction of fund raising shall be imposed;
- if violation continues, operating license shall be revoked and face legal challenge.

2. Commercial banks violating the determination of lending rates as written in this agreement shall face with following measures:

2 - shall receive a written warning;
if violation persists after first warning, a fine valued 0.01% of total credit at the end of the month shall be made;
- if fined for 3 consecutive months, suspension or restriction of lending activity shall be imposed;
- if violation continues, operating license shall be revoked and face legal challenge

3. Any commercial banks do not update/report interest rate data on time, inaccurate reporting or not complying with Article 2 of this Agreement shall face
3 with following measures:
1) in case of not submitting report on time:
- receive a written warning after the first time;
- after first warning, a fine of LAK1 million/day shall be imposed if still violating

– ຈະຖືກກ່າວເຕືອນເປັນລາຍລັກອັກສອນ;

– ໃນກໍລະນີກ່າວເຕືອນແລ້ວ ຍັງສືບຕໍ່ລະເມີດ ຈະຖືກປັບໃໝ 1.000.000 ກີບ ຕໍ່ວັນ.

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2) in case of misreporting
- written warning
- if violation continues, a fine between LAK 1 million to 10million shall be imposed;
- suspending or demoting high ranking management;
-restricting fund raising and lending activities, or use other measures as considered necessary by BoL
- revoke the business operating license and proceed the legal matters.

Article 4 Commercial banks, Monetary Policy Department, Commercial Banks Management Department, BoL Branches shall strictly implement this agreement.

Article 5 This agreement shall replace the Agreements on the determination of commercial banks' interest rates no. 529/BoL, dated 21 July 2015 and the Agreement on Determination of the Difference between Deposition Interest rates and Loan rates averaged in balancing foreign currencies of commercial banks no. 1231/BoL dated 8 December 2017. This agreement shall be put into force upon the signing date onwards.

Governor of BoL

Sonexay Sitphaxay

1231/ທຫລ, ລົງວັນທີ 08 ທັນວາ 2017, ຂໍ້ຕົກລົງສະບັບນີ້ມີຜົນສັກສິດນັບແຕ່ວັນລົງລາຍເຊັນເປັນຕົ້ນໄປ.

ຜູ້ວ່າການທະນາຄານແຫ່ງ ສປປ ລາວ

ສອນໄຊ ສິດພະໄຊ