



CONVERTING FOREIGN NON-GOVERNMENT GUARANTEED LOAN INTO CONTRIBUTED CAPITAL IN VIETNAM

The below Legal Summary prepared by BLG contains a brief discussion with tailored practical information for investment and business activities in Vietnam.

The article concentrates on the converting foreign non-government guaranteed loan into contributed capital in Vietnam.

To meet capital demands, many enterprises choose to obtain loans not guaranteed by the Government (*the “Borrower” or the “Company”*) from their offshore parent companies, existing foreign shareholders/members/owners or other offshore entities (*the “Lender”*). Converting those loans into contributed capital in the Company is a popular debt settlement solution (*“Loan Conversion”*). Loan Conversion is known as the Lender, instead of recovering the debt, will use that amount to “purchase” the shares/stakes in the Company. Consequently, the Lender (including the party receive the debt assigned/transferred by the Lender) will become the owner/shareholder/member of the Company while the charter capital of the Company will be increased equivalent to the converted loan.

This article shall concentrate on some notes that a Company should pay attention to when conducting the Loan Conversion.

1. Agreement on Loan Conversion

First of all, the Company and the Lender need to make a written agreement on converting the current loan into contributed capital. In this document, it should clearly express the time, amount of conversion and capital in proportion, plan to handle interest and principal or late payment interest, etc. Then, the Loan Conversion goes through three main administrative procedures at competent authorities including (i) M&A Approval (*defined in Section 1*) (if required) (*the “M&A Approval”*); (ii) adjustment of enterprise registration certificate (*the “ERC”*) and the investment registration certificate (*the “IRC”*) (if any) in regard to the capital increase; (iii) registration or notification of change of the loan at State Bank of Vietnam (*the “SBV”*).

2. M&A Approval

As the Lender shall become a shareholder/member of the Company, in order to get the Loan Conversion enforceable, the Lender is required to register for capital contribution/purchase of shares/stakes for approval of competent authority in the following cases^[1]:

- (a) the Company has any business lines with market access conditions as stipulated in Annex 1 of Decree No. 31/2021/ND-CP.
- (b) the Company is granted the land use right certificate for land on island or in a commune, ward, town at border area; in a coastal commune, ward, town; or in another area affecting national defense and security.
- (c) as a result of Loan Conversion if implemented, the ownership ratio in the Company of the Lender together with all other foreign investors and

^[1] Article 26.2 of Law on Investment 2020.

enterprises specified in Clause 1 Article 23 of Law on Investment 2020^[2] is over 50% of the charter capital.

In the event that the Company and the Lender fully satisfy the conditions as prescribed by laws, the competent authority shall issue the M&A Approval referring to, inter alia, the expected charter capital ownership ratio of the Lender after the Loan Conversion.

3. Adjustment of ERC and IRC

Following the M&A Approval, the Company shall implement the Loan Conversion by increasing its charter capital in proportion to the loan converted. Some works to be done are obtaining all relevant internal approvals, issuing shares, updating the registry of shareholders/members...

Within 10 days from the date of completing the Loan Conversion and increasing the charter capital, the Company has to conduct the procedure to register the change of its ERC in regard to the charter capital, the information of members (*for limited liability company*) or notify the change of foreign investors (*for joint stock company*).

Besides, in case the Company is granted a relevant IRC, the Company shall also adjust the capital, information of foreign investors recorded in its IRC to update new information.

In addition, if the Company gets an approval on investment policy and the Loan Conversion shall lead to the increase of its total investment capital by 20% or more, thereby changing the scale of the granted project, the Company has to apply for relevant adjustment to the approval on investment policy prior to IRC adjustment^[3].

^[2] **Clause 1 of Article 23 of Law on Investment 2020:**

1. When making investment in establishment of other economic organizations; contribution of capital to, or purchase of shares or capital contributions at, other economic organizations; or investment in the form of BCC, economic organizations must meet the conditions and shall carry out investment procedures according to regulations applicable to foreign investors if falling into one of the following cases:

- a) Having over 50% of their charter capital held by a foreign investor(s), or having a majority of their general partners being foreign individuals, for partnerships;
- b) Having over 50% of their charter capital held by an economic organization(s) specified at Point a of this Clause;
- c) Having over 50% of their charter capital held by a foreign investor/foreign investors and an economic organization/economic organizations specified at Point a of this Clause.

^[3] Point e Clause 4 and Clause 7 of Article 41 of Law on Investment 2020.

4. Registration or notification in regard to the changes of loan

For short-term loans, the Company needs to report to the SBV regarding converting loans into investment capital through traditional or electronic forms as prescribed.

For medium and long-term loans, the Company needs to register loan changes with the SBV^[4].

In practice, one confusing issue of Loan Conversion is cash flow as there are different regulations on cash flow of loan and that of capital contribution/payment for shares/stakes from Lender to the Company.

- **For the cash flow of capital contribution/payment for shares/stakes:**

It is compulsory that foreign investors contribute/make payment for shares/stakes of a FDI enterprise^[5] via that Company's direct investment account ("*DICA*")^[6] while they has to open their indirect investment account ("*IICA*") when doing so in a non-FDI enterprise^[7].

^[4] Clause 1 of Article 17 of Circular 12/2022/TT-NHNN dated 30 September 2022 ("*Circular 12/2022*").

^[5] Pursuant to Clause 2 of Article 3 of Circular 06/2019/TT-NHNN dated 26 June 2019 ("*Circular 06/2019*"), FDI enterprises include:

a) Any enterprise whose members or shareholders are foreign investors and granted the investment registration certificate in accordance with law on investment.

b) Any enterprises other than those prescribed in Point a of this Clause and at least 51% of charter capital of which is owned by foreign investors as follows:

(i) Any enterprises (operating in conditional business lines or without conditions applicable to foreign investors) at least 51% of charter capital of which is held by foreign investors through contribution purchase of shares/stakes;

(ii) Enterprises derived from division, acquisition, consolidation whose 51% of charter capital is owned by foreign investors after such events.

(iii) New enterprises established in accordance with relevant laws;

c) Project enterprises established by foreign investors to implement PPP projects in accordance with law on investment.

^[6] Clause 1 of Article 5; Point a, b of Clause 1 of Article 6 of Circular 06/2019.

^[7] Article 6; Point a, Clause 2 of Article 7 of Circular 05/2014/TT-NHNN dated 12 March 2014.

- **For the cash flow of loan^[8]:**

For FDI enterprise, the Company must use its DICA to process receipts and expenditures in connection with the medium and long-term loan while it is entitled to choose either DICA or another loan account for those purposes.

For non-FDI enterprise, the Company has to open a foreign loan account to conduct money transfer transactions relating to foreign loans (including fund withdrawal, principal and interest payment).

Pursuant to the above regulations, there may be a case that, at the time receiving the loan, the Company is not FDI, so the loan is transferred via foreign loan account (not DICA). However, upon the Loan Conversion, the Company shall become a FDI enterprise, therefore, the capital contribution must be transferred via DICA.

Since the loan was previously transferred to the loan account and after the M&A Approval is granted, there will not be any actual funds transferred from the Lender to the Company. That leads to the concern about the legal risk that the capital contribution of the Lender may not be legally recognized due to a “cash flow” issue.

There is an opinion^[9] that this risk exists and mainly comes from the fact that the current legal framework related to investment and foreign exchange has many inconsistent points. In addition, the current law does not have any specific provisions for converting loans into contributed capital. However, this risk is not fatal because:

- When conducting the loan transaction, the Company and the Lender have properly and fully complied with the related regulations; and
- In essence, the Loan Conversion should be understood as the fact that the Lender contributes capital to the Company through "collection rights" rather than in "cash". From the perspective of “debt collection rights”, this contribution simply cannot be done through DICA because it is not “cash”.

To reduce a risk as far as possible, in the event that the Company is FDI and already has a DICA at the time of borrowing, the loan should be transferred through DICA (although may not be required) to facilitate the Loan Conversion later. In other cases, the Company may refer to the above for explanation.

^[8] Article 26 of Circular 12/2022.

^[9] Bao Nguyen, <https://kienthucphaply.com/van-de-phap-ly-ve-dong-tien-doi-voi-khoan-vay-nuoc-ngoai-va-viec-chuyen-doi-khoan-vay-nuoc-ngoai-thanh-von-gop/>, last accessed on 26 December 2022.

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