

ADB



KINGDOM OF CAMBODIA
NATION RELIGION KING

FINANCIAL SECTOR BLUEPRINT FOR 2001-2010

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CURRENCY EQUIVALENTS

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Currency Unit	–	Cambodia riel (KR)
KR1.00	=	\$0.00026
\$1.00	=	KR3835

ABBREVIATIONS

ADB	–	Asian Development Bank
BIS	–	Bank for International Settlements
BSD	–	Bank Supervision Department, National Bank of Cambodia
CAMINCO	–	Cambodian National Insurance Company
CBS	–	Centre for Banking Studies
DFI	–	development financial institutions
FDI	–	foreign direct investment
FTB	–	Foreign Trade Bank
FIR	–	financial interrelation ratio
GDP	–	gross domestic product
IAS	–	International Accounting Standards
IFAC	–	International Federation of Accountants
IFC	–	International Finance Corporation
IMF	–	International Monetary Fund
ISA	–	International Standards on Auditing
IT	–	information technology
MEF	–	Ministry of Economy and Finance
MFI	–	microfinance institution
MOC	–	Ministry of Commerce
MSD	–	Microfinance Supervision Department
NBC	–	National Bank of Cambodia
NBFI	–	nonbank financial institutions
NGO	–	nongovernment organization
PCA	–	Prompt corrective action
PPTA	–	project preparation technical assistance
PRGF	–	poverty Reduction and Growth Facility
RDB	–	Rural Development Bank
SEC	–	Securities and Exchange Commission
SEDP	–	Socioeconomic Development Plan
SME	–	small- and medium-sized enterprise
T-Bill	–	Treasury Bill
TA	–	technical assistance

NOTE

In this report, “\$” refers to US dollars.

FOREWORD

Since the mid 1980s, Cambodia has embarked on economic reforms and reached a no-U turn in 1989, when private property rights were restored and price control was abolished. State-owned enterprises were privatized and increased incentives were provided to local and foreign private investment. This set the stage for the signing of the Paris Peace Accord in 1991, designed to put an end to the protracted civil wars and rehabilitate the economy. After the 1993 general elections, the newly formed Royal Government of Cambodia (the Government) began formulating a comprehensive macroeconomic and structural reform and achieved some significant successes in stabilizing the economy. The economy has expanded rapidly during the first half of 1990s, while inflation has been dramatically reduced.

Progress was also made in implementing structural reforms: a two-tier banking system is being put in place and new large denominated banknotes were introduced to promote “de-dollarization”; most non-tariff barriers were eliminated; the tariff structure was streamlined; a liberal foreign investment law was adopted; and the spread between the official and parallel market exchange rates has been substantially reduced. Since then, Cambodia has made impressive strides in re-establishing political and economic stability and re-integrating itself into the international community. However, the Government is conscious that an economy will not reach its growth potential and develop at an adequate pace, without an active contribution from the financial sector. Therefore, the Government is committed to strengthening the financial system and, over the recent years, has been enacting legislation, adopting policies, creating institutions and adapting procedures as part of the financial sector reforms in order to quicken the pace of economic growth.

Financial sector development is important to the speed and direction of economic growth, since a strong and well-functioning financial sector can break down the limitations of self-financing, mobilize idle financial resources for productive investment needs. To link up

saving, investment and economic growth, the financial sector development must go hand in hand with private sector development and governance reform, forming three pillars to underpin the Government’s policy of generating growth, which is seen as the major means to reduce people poverty, the ultimate goal of the Government’s economic policy.

The banking sector in particular needs strengthening, given its current low level of development and its dominant position in the present financial system. Cambodia’s banking system was thus transformed from a mono banking into a two tier banking system by separating the central bank functions from commercial banking activities. To support the reform, legislative framework has been improved. The new central bank law is promulgated in January 1996, providing better clarification of the Bank’s status, ownership and capital structure, and laying a more solid foundation for its operations. Along with re-defining the new role of the National Bank of Cambodia, the Government is fully aware of the need to address the remainders of the financial system with a view to establish a modern and efficient financial sector. The Law on Banking and Financial Institutions, enacted in November 1999, represents therefore a great asset for the nascent’s financial sector. This new law responds to the need to promote a sound financial structure and orderly financial markets by providing appropriate legal framework for the licensing, organisation, operation, and supervision of a broad range of financial services companies. In addition, the Insurance Law was passed in June 2000.

To strengthen the banking system in the earlier 2000 the National Bank of Cambodia introduced bank-restructuring program, requiring the existing banks to increase their capital base and to comply with relevant laws and regulations. As a result, in November 2000, nineteen banks were allowed to continue operations, while twelve others were de-licensed and put under liquidation procedure. With these actions, the

Government has in mind to bring up all existing banks to a higher standard, improving the soundness and reliability of the banking system, which is crucial for confidence building.

While much progress has been made in recent years in financial sector reform, still many things remain to be done to support increased investment and high and sustainable economic growth rate. Creating a modern and efficient financial system is not an easy task. The Government needs to fully understand what it needs, which direction to go and how to get there. In this spirit, the Government has requested assistance from the Asian Development Bank (ADB) to develop a financial sector development plan for Cambodia. In fully understanding the need of Cambodia, ADB has positively responded to the request and started its assistance with an initial sector study to develop strategic objectives and identify key issues in the financial sector. Through this study, a preliminary financial sector “roadmap” was drafted in June 1999.

Based on this preliminary document, ADB launched a project preparation technical assistance in December 2000 (TA 3467-CAM: Preparing the Financial Sector Development Program) to assist the Government in producing a practical and implementable master plan for the financial development for the next 10 years. Also for this purpose, on the side of the Government, the Committee on Economic and Financial Policies, established by the governmental decree dated 10 June 1997 and chaired by the Minister of Economy and Finance, entrusted H.E. Chea Chanto, Governor of the National Bank of Cambodia and Deputy Chairman of the Committee on Economic and Financial Policies, to lead a Financial Sector Steering Committee (FSSC), established in April 2000, with senior representatives from the Ministry of Economy and Finance, the National Bank of Cambodia, the Ministry of Commerce and the Council of Development of Cambodia as members, in order to ensure the ownership of this important master plan. In addition, a Working Group (WG), which consisted of representative of the above institutions, was set up to assist the FSSC in all technical aspects related to the matter. The National Bank of Cambodia acted also as the executing agency and coordinator with the ADB.

In the course of preparing the Blueprint, numerous meetings were organized, including the consultation and consensus-building seminars to solicit views from across the interested spectrum and to build a common understanding on the future prospects of the financial sector in Cambodia. The whole process has been marked, by a partnership between the Government and the private sector in taking strong ownership of financial sector reform in Cambodia.

Thank to the efforts of all parties involved, especially, the Cambodia Team of ADB’s Financial Sector and Industry Division, in July 2001 a draft Blueprint called “ Vision and Financial Sector Development Plan for 2001-2010 “ has been finalized. On the 24th August 2001 during a plenary session at the Council of Ministers, chaired by Samdech Hun Sen, the Government adopted the document as an official long-term plan for the financial sector development and is part of an overall Government’s reform agenda toward establishing a more market-based, open, and private-sector led economy.

With the Blueprint, each important component of the financial sector that is being developed or will be developed by individual and separate efforts of the relevant organizations have been coordinated, streamlined in a handed and systematic manner and reflected in one document.

The Blueprint envisages the development of a sound, market-based financial system in ten years that will enhance resource mobilization and sustainable economic growth. It addressed relevant sub-sectors to be developed within a period from 2001 to 2010. That is, in ten year from now, Cambodia will have:

- (i) a competitive, integrated, and efficient banking system that is properly regulated and supervised and effectively mobilizes savings to provide financing to support the growth of the private sector, a reliable payment system and banking safety nets.
- (ii) a viable, pro-poor and effective rural finance system for providing affordable financial services to enable the poor to enhance rural income and reduce poverty.
- (iii) an insurance sector that protects businesses and individuals from catastrophic events and a pension system that provides a secure retirement, both of which provide capital for long-term investment in the real sector.
- (iv) diverse non-banking financial products and institutions that create more balanced financial structure, increase the depth of financial market, and promote competition. These include leasing business, money market and capital market intermediaries, and development finance institutions.
- (v) a money market that enables an inter-bank market that provides banks, companies, and individuals with the means for effective liquidity managing.

- (vi) an efficient and transparent capital market with a critical mass of issuers that mobilizes funds for long-term investment.
- (vii) legal and accounting systems that promotes the rule of law in commercial and financial transactions and support good governance by promoting transparency, accountability, and predictability.

The Financial Sector Development Plan also emphasizes, in addition to the institutional and legal strengthening of the financial sector, the need to develop a reliable financial information system and to introduce an efficient mechanism to build up manpower capable to face with the future challenges.

To ensure its successful implementation, the Blueprint has been structured as a step- by-step plan. Intermediate reform agenda has been formulated to help identify specific measures and to set the sequence and pace for the implementation of those measures. Another important feature of it is the built-in flexibility within the reform agenda, which allows the Government to make necessary policy adjustment to reflect progress made along with the changing conditions.

The Government of Cambodia wishes to express its special gratitude to the Asian Development Bank for producing this important document. Without the Bank's invaluable support, guidance and technical assistance, the realization of this paper would not have been possible.

Our acknowledgement also goes to the consultant team for its contributions and preparations of the groundwork for the document.

The "Vision and Financial Sector Development Plan for 2001-2010" reflects also the efforts of the Financial Sector Steering Committee and its Working Group. Their inputs and responsibilities in fulfilling their mission are highly valued.

Although the implementation of the Financial Sector Development Plan represent great challenges for the policy makers and implementing agencies alike, the Government trusts that with their determined commitments and efforts and their ownership spirit over the duty, combined with support from various donors and well-wishers, Cambodia will be able to materialize the visions set out in this document.

Phnom Penh, 2 October 2001



Keat Chhon
Senior Minister
Minister of Economy and Finance



Chea Chanto
Governor
National Bank of Cambodia

PREFACE

Peace finally came to Cambodia in 1993 after a long period of domestic strife and international isolation, when the country promulgated a new Constitution declaring liberal democracy and a multiparty system. Under the aegis of the international community, the Government has made tremendous efforts to reform the governance structure toward a liberal democracy and a market economy. It has also launched a comprehensive Socieconomic Development Plan assisted by the Asian Development Bank (ADB). Sustained political stability and the Government's commitment to multifaceted reforms have shed light on economic prospects and opportunities for the embryonic private sector and have given impetus to wide-ranging social rehabilitation.

However, Cambodia still has a long way to go to achieve broad-based economic and social development. The Government needs to forge ahead with governance reform and to develop the enabling framework for private sector development. In particular, the underdeveloped financial system, with low public confidence and limited intermediation, has been a main impediment to private sector development and thus to broad-based economic growth.

In 1999, in recognition of the strategic importance of financial sector development, the Royal Government of Cambodia requested ADB for assistance in developing the country's nascent financial sector. ADB embarked on an initial sector study to identify key issues. Based on this initial study, ADB launched project preparation TA (TA 3467-CAM: Preparing for the Financial Sector Development Program) in December 2000 to formulate a long-term development strategy and the first financial sector development program. In March 2001, the Cambodia Team of ADB's Financial Sector and Industry Division (West) produced the first draft of the financial sector strategy, called the *Financial Sector Blueprint for 2001-2010* (the Blueprint), together with the Financial Sector Program to support the implementation of the Blueprint.

The Blueprint is to serve as the financial sector strategy for ADB and the Government as well as the coordination panel for external assistance. For better planning, the 10-year period is divided into three phases: Phase I covers 2001-2004, which will be supported by ADB's Financial Sector Program Loan which will be considered by ADB's board in November 2001; Phase II spans from 2005 to 2007; and Phase III covers 2008-2010.

The Blueprint is based on previous efforts in Cambodia by ADB, the International Monetary Fund, and the World Bank. The development of the Blueprint benefited from two key seminal works of ADB: *Financial Management and Governance Issues in Cambodia: Diagnostic Study of Accounting and Auditing* and *Cambodia: Enhancing Governance for Sustainable Development*.

The Blueprint is a collective asset of ADB and the Royal Government of Cambodia; it has been developed with the full support and active participation of the Government and private sector stakeholders. The Government, especially the Ministry of Economy and Finance, the Ministry of Commerce, and National Bank of Cambodia, has reviewed different versions of the Blueprint and provided valuable insights and comments. The draft Blueprint has also been the subject of consultation seminars with the private sector. Many useful comments and suggestions were provided both during the seminars and through the e-mail address set up for the Blueprint (blueprint@hotmail.com). The whole process has been marked by a partnership between the Government and the private sector in taking strong ownership of financial sector reform.

We would like to extend special gratitude for the leadership and guidance of H.E. Keat Chhon, Senior Minister of the Ministry of Economy and Finance; H.E. Chea Chanto, Governor of the National Bank of Cambodia; and H.E. Sok Siphana, Secretary of State, Ministry of Commerce. In addition, significant

contributions and guidance were provided by the following from the Ministry of Economy and Finance: H.E. Aun Porn Moniroth (Secretary General), H.E. Ngy Tayi (Under Secretary), Mey Vann (Deputy Director), Pen Thirong (Deputy Director), Ken Sambath (Deputy Director and Assistant to Senior Minister), Minh Ban Kosal (Secretary Group to the Prime Minister and Assistant to Economic Advisor to the Prime Minister and Secretary General), Vong Bunintreavuth, and Rath Sa Rath; and by the following from the National Bank of Cambodia: H.E. Sum Sannisith (Secretary General), Tal Nay Im (General Director), and Nguon Sokha (Deputy Director). Special thanks also go to all private sector participants in the seminars, notably, Sok Kong (President, Phnom Penh Chamber of Commerce), Ow Soon Wing (SBC Bank, Singapore Banking Corporation Ltd.), Chan Kok Choy

(General Manager, Cambodia Public Bank Ltd.), and S. Choy (First Overseas Bank).

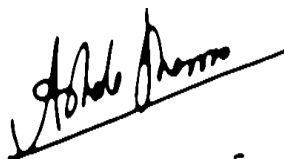
Equally important, we would like to thank Christine Wallich (Director, Infrastructure, Energy and Financial Sectors Department, West) and Thomas Crouch (Manager, Financial Sector and Industry Division, West) for their continuous encouragement and support. We also wish to acknowledge the essential contributions and groundwork of the consultant team led by Arun Hsu (Financial Sector Specialist) and comprising Donald Simonson (Economist), John McCoy (Banking Expert), John Hepp (Accounting Expert), Tia Savora (Economist), and Nay Chhuon (Training Coordinator). Finally, we are grateful to Thomas Rumbaugh (Deputy Division Chief, Asia and Pacific Department, International Monetary Fund) and his mission for sharing their valuable experiences and providing support along the way.



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EXECUTIVE SUMMARY

Financial sector development in Cambodia, under the current socioeconomic and legal environment, poses a daunting challenge to the Government as well as to the private sector. Although efforts have been made on many fronts, it is the view of the Government that Cambodia needs to exert coherent and systematic efforts to develop a sound market-based financial system to support resource mobilization and broad-based sustainable economic growth.

With these objectives in mind, the Government has formulated a long-term vision and development strategy for the financial sector with ADB technical assistance. The vision and strategy were developed based on key lessons drawn from the experience of other Asian economies in financial sector development, as well as from the current situation in Cambodia.

Long-term Vision and Development Strategy

Financial sector development crucially depends on governance reform. One of the critical governance challenges facing Cambodia is to strengthen the accountability of institutions in the public sector. The necessary reforms include, among others (i) legal and judiciary reform, (ii) public administration reform, and (iii) public finance reform.

If the governance reform programs envisaged in the Socio-Economic Development Plan II and the Governance Action Plan are fully implemented, it is expected that the Cambodian economy will be

able to sustain an average annual economic growth rate of 6-7 percent over the medium term.

Building on such development prospect, the Blueprint anticipates that the financial sector will at least double in terms of the ratio of financial assets to gross domestic product in 10 years. The spread between loan and deposit rates will narrow as intermediation becomes more efficient owing to macroeconomic stability, improved legal and financial infrastructure, and increased competition among banks and other financial institutions.

The vision will be achieved by ensuring the following:

- (i) a competitive, safe, and sound banking system that is well regulated and supervised, and effectively mobilizes savings to provide financing to support the growth of the private sector;
- (ii) the establishment and development of nonbank financial institutions (NBFIs) that will increase the depth of the financial sector by providing a broad array of diversified services such as leasing and consumer finance;
- (iii) an insurance sector that protects businesses and individuals from catastrophic events and a pension system that provides a secure retirement, both of which provide capital for long-term investment in the real sector;
- (iv) a safe and reliable system for the transfer of funds between customers and banks,

and for the settlement of payments between banks;

- (v) money/interbank markets that provide banks, companies, and individuals with the means for effective liquidity management;
- (vi) efficient and transparent capital markets with a critical mass of issuers that mobilize funds for long-term investment;
- (vii) a legal system that promotes and enforces the rule of law in commercial and financial transactions and that supports good governance by promoting transparency, accountability, participation, and predictability;
- (viii) an accounting and auditing system based on international standards that supports good governance by promoting transparency, accountability, participation, and predictability; and
- (ix) human resource development employing performance-based compensation and promotion and the availability of a broad range of professional programs to retrain existing staff and provide ongoing training.

The Government has adopted a long-term strategy for financial sector development that comprises the following elements:

- (i) maintaining sound fiscal and monetary policies to ensure macroeconomic stability;
- (ii) establishing a sound legal framework to protect property rights and enforce contracts;
- (iii) establishing the rule of law through legal/judicial reform to underpin financial and commercial activities;
- (iv) sequencing efforts to develop financial infrastructure, particularly the payment/

clearing system, accounting and auditing system, credit information system, and regulatory framework;

- (v) structuring the regulatory and policy framework to foster competition in the financial markets and to encourage financial institutions to realize economies of scale and scope;
- (vi) establishing a regulatory and institutional framework to promote sound governance principles and to allow market discipline to work in the management and operations of financial institutions;
- (vii) establishing a sound framework for private sector development in the financial system by phasing out state ownership and state intervention in the system;
- (viii) developing a transparent entry framework to encourage efficiency and financial deepening;
- (ix) developing efficient exit mechanisms for troubled institutions to foster continuous reorganization in the financial system without incurring social costs; and
- (x) developing human and institutional capacity in both the private and public sectors through public-private sector partnerships.

Sector Development Plan

Under the guidance of the long-term strategy, the Blueprint details sector development strategy and policy reform agenda. The sector development plan explicitly considers the interrelationship of (i) human and institutional capacity building, (ii) developments in related financial infrastructure, (iii) establishment of a legal and regulatory framework, (iv) emergence of relevant financial markets, and (v) availability of technology. The sector development strategy is a rolling plan, which needs continuous updating to reflect the Government's achievements as well as the changing

socioeconomic environment. The Government is committed to implementing the sector development plan specified in the Blueprint, as well as to continuously updating the sector development plan to reflect the Government's achievements and the changing socioeconomic environment, thus maximizing the development impact.

The Banking Sector

The Blueprint for the banking sector consists of three phases. The first phase aims at laying the foundation for the banking system by establishing a basic policy and institutional framework. The second phase targets enhancing intermediation through competition. Building on the achievements in the first phase, the banking system should be developed into a more consolidated system through competition among banks and intermediation will be expanded, while banking services will be extended to rural areas. The third phase aims to promote intermediation efficiency by facilitating the integration of the formal and informal financial sectors as well as the reorganization of the banking industry. An integrated banking sector will also enhance the efficiency and quality of banking services in rural areas.

The Insurance Sector and Pension System

The development of the insurance sector will also go through three phases. To improve the current weak legal infrastructure and supervisory capacity, the first phase aims at establishing the foundation and building capacity for the sector. With a solid foundation in place, the insurance sector will develop in size and diversity. The focus of the second phase will be to promote the insurance market through private sector development, to increase the outreach to poor and rural areas, to implement compulsory insurance, and to enhance product variety. The implementation of compulsory insurance will create policy-driven demand, and the growing income will generate demand for a greater variety of insurance products. In response to the growing sophistication and volume of business in the insurance sector, an independent insurance supervisor will be established. As the sector further

expands, the independent insurance supervisor will further upgrade prudential regulations in the third phase.

During the first phase of pension system development, the feasibility and design for establishing a multi-pillar pension system will be completed. During Phase II, the legal, regulatory, and supervisory frameworks will be established for the pension system. In addition, a capacity-building mechanism will be needed to ensure properly trained staff in the regulatory and supervisory body. During Phase III, the legal framework will be enhanced through the issuance of sub-decrees. The mandatory public pension program will be launched and the supervisory and regulatory framework will be further strengthened in anticipation of the implementation of the mandatory privately managed funded pension program that will be implemented after Phase III.

Nonbank Financial Institutions

The development of nonbank financial institutions (NBFIs) begins in the second phase. The development goal is to provide a legal and regulatory framework for NBFIs commensurate with the development of interbank/money markets and capital markets. Thus the goal of Phase II is to establish the legal and regulatory foundation for NBFIs such as leasing companies, finance companies, investment companies and money market broker/dealers. The goal of Phase III is to further develop the NBFIs, including trust companies, venture capital companies and development financial institutions (DFIs). These institutions will support the development of money and capital markets.

Interbank/Money Markets

The sequencing and pacing of money market development will match the development of the banking and nonbanking sectors. The development plan for interbank/money markets targets three strategic goals. The first phase aims to establish the foundation for a market in short-term unsecured interbank lending, and to provide a base for money markets (including Treasury Bills), based on a

Negotiable Instruments Law. The second phase will strengthen the interbank markets by establishing regulations for diverse money market instruments such as negotiable certificates of deposit and repurchase agreements, as well as by regularizing the issuance of Treasury Bills with the development of a primary dealer system. The third phase is to broaden money markets with a regulatory framework for nonfinancial issuers of money market instruments such as commercial paper.

Capital Markets

The capital market development plan consists of three sequenced development goals over 10 years. During the first phase, necessary preparatory work is expected to create an enabling environment for capital markets. In the second phase, it is envisaged to establish the foundation for capital markets by developing the necessary infrastructure related to securities trading, as well as by adopting detailed regulations and procedures. Building on the preparatory work, it is expected that the Government will continue a systematic effort to develop capital markets in the third phase.

Financial Market Infrastructure

Legal Infrastructure. The development of the legal infrastructure for financial markets also targets three reform agenda over the next 10 years. The goal in Phase I is to introduce key laws pertaining to commercial activities to underpin financial sector development. In Phase II, law enforcement will be strengthened with the progress in court reforms and capacity building. Phase III will focus on enhancing legal infrastructure for private sector development; during the period, a legal framework for public registration system for movables will be established.

Accounting and Auditing System. The accounting and auditing system is the base for financial sector development and demands urgent attention. The goal in Phase I is to establish accounting and auditing standards and a system for

their enforcement through promulgation of a Law on Corporate Accounts, their Audit and the Accounting Profession; adoption of International Accounting Standards/International Standards on Auditing; and establishment of an accounting professional body and an accounting standards board. In Phase II, the accounting association will strengthen the enforcement of accounting and auditing standards, and promote competition in the accounting industry to reduce the accounting and auditing compliance costs of the private sector. In Phase III, enforcement of accounting standards and expansion of International Accounting Standards to more firms will occur.

Financial Information Infrastructure.

Development of a financial information system is crucial to cultivate a credit and repayment culture in the early stage of financial development. In Phase I, the Government will create the financial market information system via banker-led arrangements for sharing credit information. During Phase II, the Government will expand the scope of the arrangements to nonbank institutions. In Phase III, the financial market information system will be further diversified by introducing a credit rating industry.

Financial Sector Safety Nets. Financial safety nets will be developed to bolster public confidence in the financial system. As the financial system expands, so do the systemic risks. The development of the financial safety nets includes a two-stage reform agenda starting from Phase II. The goal of Phase II is to develop banking sector safety nets with the establishment of deposit insurance and corporate governance guidelines. Phase III will expand the deposit insurance system to the nonbanking sector participants who join the payment system.

Successful implementation of the Blueprint relies on strong leadership, firm commitment, and tremendous efforts by the Government, especially, the Ministry of Economy and Finance, the Ministry of Commerce, and the National Bank of Cambodia. It also calls for the support of the private sector and the timely assistance of international aid agencies, since the active participation of the private sector and international agencies is indispensable as a source of knowledge input for successful implementation of the Blueprint.

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