

ASIAN DEVELOPMENT BANK

TAR:CAM 36593

**TECHNICAL ASSISTANCE
TO THE
KINGDOM OF CAMBODIA
FOR
IMPROVING INSURANCE SUPERVISION**

December 2002

CURRENCY EQUIVALENTS

(as of 3 December 2002)

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

ABBREVIATIONS

ADB	–	Asian Development Bank
ASEAN	–	Association of Southeast Asian Nations
CAMINCO	–	Cambodia National Insurance Company
FID	–	Financial Industry Department
FSPL	–	Financial Sector Program Loan
MEF	–	Ministry of Economy and Finance
TA	–	technical assistance

NOTE

In this report, "\$" refers to US dollars.

This report was prepared by a team consisting of B. J. Chun (team leader) and X. Zhang, Mekong Department.

I. INTRODUCTION

1. The Cambodian insurance industry is in its embryonic stage. Given the limited banking intermediation in the country, the development of the insurance business is of strategic importance. It will complement banking intermediation and contribute to long-term resource mobilization. Nonlife insurance, especially, will facilitate commercial activities by covering various business risks. Appendix 1 summarizes initial poverty and social analysis.

2. The Asian Development Bank (ADB) has been instrumental in developing the insurance business. ADB helped the Government develop a long-term financial sector development plan—the Financial Sector Blueprint for 2001–2010 (the Blueprint),¹ which identified key reform areas to build a market-based insurance industry over 10 years starting in 2001. The Blueprint addresses (i) the supervision and regulatory framework, (ii) compulsory insurance, (iii) insurance industry organization, (iv) capacity building, and (v) insurance infrastructure. Based on the Blueprint, ADB launched the Financial Sector Program Loan (FSPL) cluster² to help implement the proposed reforms in the Blueprint. The FSPL supports (i) establishing an insurance supervisory unit, (ii) developing compulsory insurance, and (iii) restructuring the state-owned insurance company. ADB provided advisory technical assistance (TA)³ in 2002, which covered compulsory insurance such as third-party-liability motor vehicle insurance and contractor's general liability. Following this initial effort, the Government requested further assistance through a long-term resident advisor to develop the insurance sector, especially in the legal and supervisory framework, restructuring of the state-owned insurance and reinsurance companies, and capacity building of supervisory staff of the Ministry of Economy and Finance (MEF). In response, ADB fielded the Fact-Finding Mission⁴ of 14-25 October 2002, and reached an understanding on the scope, implementation and financing arrangements, and terms of reference of the TA.⁵

II. ISSUES

3. The insurance industry is very small and underdeveloped. The insurance industry comprises the state-owned Cambodia National Insurance Company (CAMINCO), four private insurance agents, and a state-owned reinsurance company—the Cambodia Re. In recent years, the insurance industry has undergone some important changes. First, CAMINCO was divested of its regulatory function, which MEF took over in line with the insurance law of 2000.⁶ Until then, CAMINCO had regulated the insurance industry, posing conflicts of interest. MEF established the Insurance Division under the Financial Industry Department (FID). Second, in January 2002, CAMINCO was divested of its reinsurance business when the Government established Cambodia Re. In October 2002, it was transformed into a joint venture company with the Asia Insurance Group,⁷ which holds 20% of Cambodia Re. Third, compulsory insurance has been introduced. Until recently, only a few nonlife insurance products such as property, health,

¹ Chun, B. J., X. Zhang, A. Sharma, and A. Hsu. 2001. *Cambodia: Financial Sector Blueprint for 2001-2010*. Manila: ADB. Available: http://www.adb.org/Documents/Reports/CAM_Blueprint/default.asp.

² ADB. 2001. *Report and Recommendation of the President to the Board of Directors on a proposed Program Loan Cluster to the Kingdom of Cambodia for the Financial Sector Program*. Manila.

³ ADB. 2001. *Technical Assistance to Cambodia for Capacity Building for Banking and Financial Management*. Manila. The TA was approved in November 2001, and commenced implementation in April 2002.

⁴ The Mission comprised B.J. Chun (Financial Economist/Mission Leader) and X. Zhang (Financial Economist).

⁵ The TA first appeared in *ADB Business Opportunities* (Internet edition) in October 2002.

⁶ The FSPL supported the separation of CAMINCO's insurance regulatory function as part of first-tranche release conditions of subprogram 1. See footnote 2.

⁷ The Asian Insurance Group is a consortium of five international insurance companies from Japan; Hong Kong, China; Indonesia Singapore; and Thailand.

marine cargo, and motor vehicle insurance had been offered to a limited scope of clients, mostly foreign investors and international organizations. In 2002, MEF introduced compulsory insurance such as third-party-liability motor vehicle insurance, contractor's general liability, and passenger transportation insurance.

4. While these achievements are significant, the "to-do list" to build an enabling environment conducive to insurance business is a long one. First, a detailed legal and regulatory framework for insurance is urgently needed. Under the current skeletal regulatory framework, what businesses private sector operators can or cannot engage in is not clear, because many essential details remain missing. The insurance law establishes the basic legal basis for defining supervisory authorities and industry business, but MEF and the private sector feel that the law still leaves many areas to be fleshed out, or improved to give transparent guidance to insurance providers and clients. Some prudential norms (i.e., solvency margin and minimum capital requirements) need to be redesigned as they are unrealistic. For example, the minimum capital requirement for a full-fledged insurance company, set at \$7 million, is too high to induce private insurance companies, given the market size. A foreign insurance company became an agent in response to the high minimum capital requirement. The insurance law has yet to provide clear references for various insurance intermediaries such as brokers and sales agents.

5. Second, the Insurance Division has yet to establish detailed supervisory framework and prudential regulations. MEF must urgently develop the following tasks to discharge its regulatory responsibilities: (i) establish off-site surveillance and on-site inspection procedures and train the Insurance Division officers, (ii) establish a regulatory framework for a policyholder protection program, and (iii) develop an insurance database and statistics to help insurance operators determine and regulate premiums of life and nonlife businesses.

6. Third, capacity building is urgently needed for the insurance supervisory staff. The Insurance Division has 10 officers, most of whom lack insurance supervision experience. Although a few officers have a background in economics and business administration, most lack in-depth knowledge of insurance. Long-term and systematic efforts are needed to build the capacity of insurance supervisors.

7. Fourth, the insurance industry needs to be reorganized by redefining the role of the state-owned insurance companies. Until 2000, CAMINCO had been regulator, operator, and reinsurer, and remains a dominant player in the insurance market. Recognizing potential conflict of interest, MEF initiated CAMINCO's restructuring in 2000, first separating the regulatory function and then divesting the reinsurance business. The next task is to make CAMINCO a commercial enterprise and build its capacity. Based on ADB's policy recommendation, MEF plans to restructure CAMINCO by forming a joint venture with a private sector partner. A joint venture, preferably with reputable foreign insurance companies, will be of strategic importance in developing the insurance business, not only augmenting the capital base of CAMINCO, but also transferring managerial and technical know-how to it. The Government established Cambodia Re and remains committed to restructure CAMINCO through a joint venture under the FSPL's auspices.⁸

⁸ ADB. 2002. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Kingdom of Cambodia for Subprogram II of the Financial Sector Program and on the Progress of Subprogram I (Loan 1859-CAM)* (approved on 28 November 2002). Manila.

III. THE TECHNICAL ASSISTANCE

A. Purpose and Output

8. The project aims to (i) upgrade the legal and regulatory framework for insurance based on international best practices, (ii) build capacity of insurance supervisory staff, and (iii) help restructure CAMINCO by developing a restructuring strategy and action plans. An international insurance expert and a local expert will be engaged under the TA. The international insurance expert will be resident advisor to FID to help its director and staff discharge their daily operational responsibilities as insurance supervisor and regulator. The international insurance expert is expected to undertake the following tasks:

- (i) Formulate a medium-term development plan to upgrade the legal and regulatory framework for insurance business and capacity as well as the insurance industry, based on a diagnostic review of the insurance sector.
- (ii) Develop (a) procedures for on-site inspection and off-site surveillance of the insurance companies, (b) insurance industry statistics, (c) implementing regulations of accounting standards consistent with Association of Southeast Asian Nations (ASEAN) standards.
- (iii) Draft a restructuring strategy and plan for the state-owned insurance and reinsurance companies and help MEF implement the plan.
- (iv) Provide training for the relevant officials and private sector stakeholders in various policy issues regarding insurance supervision and business.

B. Methodology and Key Activities

9. The TA is unique in that it will use a resident advisor with a broad scope of tasks. Given the situation facing FID, the demand for capacity building is multifaceted, ranging from a high-level of professional knowledge and financial expertise to simple administrative skills. The resident advisor is expected to undertake multiple roles in capacity building, on top of professional consulting services. First, the advisor will be a tutor, teaching staff how to handle issues arising from FID's day-to-day operation. Since most FID staff are relatively young and inexperienced, they often face difficulties in handling routine tasks. The expert will guide them in discharging their daily responsibilities. Actual assistance in daily tasks will be provided by the domestic consultant under the guidance of the resident advisor. Second, the advisor will be an on-the-job trainer to expedite the knowledge transfer for the internal expert to the FID target staff. The resident advisor's TA service and training service can be integrated into FID staff's daily work process since the advisor and staff work in the same office. While the resident advisor is expected to provide workshop and seminar-type training, the core mechanism for knowledge transfer envisioned in this TA hinges on on-the-job training by the resident advisor. Third, the resident advisor will become a focal person to facilitate private sector consultation. As FID staff have no in-depth knowledge or experience, they do not easily communicate with private sector operators. Most FID staff do not necessarily match with private sector counterparts. Lack of mutual trust between FID and its private sector operators also hampers communication. Thus, the resident advisor will be an honest broker to bridge the communication gap between them. The TA framework is in Appendix 2.

C. Cost and Financing

10. The total TA cost is estimated to be \$472,000, of which \$333,000 is the foreign exchange cost, and \$139,000 equivalent is the local currency cost. The Government has requested ADB to finance \$333,000, covering the entire foreign exchange cost and \$67,000 equivalent of the local currency cost. The TA will be financed on a grant basis by ADB's TA funding program. The Government will finance the balance of the local currency cost, equivalent to \$72,000, by providing office space, counterpart staff, and other miscellaneous services (Appendix 3).

D. Implementation Arrangements

11. MEF will be the Executing Agency for the TA. In addition to office space, MEF will provide counterpart staff and other support services to the consultants. ADB will engage an international insurance expert and a domestic economist to provide consulting services for 9 person-months each, both on individual basis. The terms of reference for the consultants are in Appendix 4. Consultants will be selected and engaged according to ADB's *Guidelines on the Use of Consultants* and other arrangements satisfactory to ADB on the engagement of domestic consultants.

12. Before the start of services, the consultants will prepare a detailed work plan, which will include a timetable for deliverables defined under each TA component. Consultants are required to deliver outputs according to such schedule and in such format as agreed on with ADB and MEF at contract negotiation. Each output will be reviewed by MEF and ADB. The consultants are required to submit to ADB a daily activity report at the end of each working month in such format as agreed on with ADB and MEF when service starts. A draft final report, collating all outputs, will be submitted within the deadline agreed on, and work plans after incorporation of feedback from MEF and ADB. A tripartite meeting will be held before finalization of the draft final report. The final report, incorporating comments of MEF and ADB during and after the tripartite meetings, should be submitted upon completion of service. The TA is scheduled to commence in February 2003 and be completed by June 2004.

IV. THE PRESIDENT'S DECISION

13. The President, acting under the authority delegated by the Board, has approved the provision of technical assistance not exceeding the equivalent of \$400,000 on a grant basis to the Government of Cambodia for Improving Insurance Supervision and hereby reports this action to the Board.

SUMMARY INITIAL POVERTY AND SOCIAL ANALYSIS

A. Linkages to the Country Poverty Analysis

Sector identified as a national priority in country poverty analysis? Yes	Sector identified as a national priority in country poverty partnership agreement? Yes
<p>Contribution of the sector to reduce poverty in Cambodia:</p> <p>The insurance sector, as part of the financial sector, helps reduce poverty on the macro and individual levels.</p> <p>On the macro level, the insurance sector mobilizes savings and channels financial resources for productive purposes, and is fundamental for sustainable economic growth and stability. The sector supports economic growth by mobilizing resources, especially long-term resources, which is critical to infrastructure development. The insurance sector also protects the real sectors from losses in case of catastrophes and, therefore, contributes to macroeconomic stability.</p> <p>For individual livelihood, a sound and efficient insurance sector provides accessible, high-quality and well-diversified insurance services for the near poor and nonpoor. During economic or other crises, a sound financial system reduces income fluctuation and, thus, people's vulnerability to drastic changes in socioeconomic situation.</p>	

B. Poverty Analysis

Proposed Classification: Beneficiary not specific

<p>What type of poverty analysis is needed?</p> <p>None.</p>
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C. Participation Process

Stakeholder analysis prepared:	None
Participation strategy required:	No

D. Potential Issues

Subject	Significant, Not Significant, Uncertain, None	Strategy to Address Issues	Plan Required
Resettlement	None		None
Gender	None		None
Affordability	None		None
Labor	None		None
Indigenous People	None		None
Other Risks or Vulnerabilities	None		None

TECHNICAL ASSISTANCE FRAMEWORK

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
<p>Goal Develop a balanced, sound, market-based financial system to support resource mobilization and sustainable economic growth</p>	<ul style="list-style-type: none"> • Increased ratio of financial assets to gross domestic product (GDP) • Increased ratio of insurance premium to GDP • Increase per capita insurance expenditure • Enhanced and diversified insurance services in urban and rural areas 	<ul style="list-style-type: none"> • Economic reports, official statistics • Asian Development Bank (ADB) review missions 	<ul style="list-style-type: none"> • The Government's financial sector strategy is implemented. • Macroeconomic stability is sustainable. • Reforms are fully implemented as specified in the governance action plan.
<p>Purpose Increase public confidence and awareness in the insurance sector, and diversify insurance products and services</p>	<ul style="list-style-type: none"> • Higher insurance premium • Bigger insurance companies • More people with insurance • Diversified insurance products • Enhanced insurance services in urban and rural areas 	<ul style="list-style-type: none"> • Reports of insurance companies and MEF • ADB review missions 	<ul style="list-style-type: none"> • MEF is committed and has the capacity to develop the insurance sector.
<p>Outputs</p>	<ul style="list-style-type: none"> • A diagnostic study on the legal and supervisory framework of the insurance sector, and the insurance industry • A medium-term development plan to improve insurance supervision framework and capacity as well as to develop the insurance industry • Manuals and procedures for off-site surveillance and on-site inspection of the insurance companies • Design of insurance industry statistics • Implementation regulations of accounting standards • A restructuring plan for CAMINCO and Cambodia Re 	<ul style="list-style-type: none"> • Technical Assistance (TA) reports • MEF's reports • ADB review missions 	<ul style="list-style-type: none"> • MEF is cooperative and has the necessary capacity to achieve its goals. • The private sector supports the endeavor.
<p>Inputs</p>	<ul style="list-style-type: none"> • International insurance expert (9 person-months) • Domestic economist (9 person-months) 	<ul style="list-style-type: none"> • TA reports • MEF's reports • ADB review missions 	<ul style="list-style-type: none"> • MEF is cooperative and has the necessary capacity to achieve its goals.

COST ESTIMATES AND FINANCING PLAN
(\$'000)

Item	Foreign Exchange	Local Currency	Total Cost
A. Asian Development Bank Financing			
1. Consultants			
a. Remuneration and Per Diem			
i. International Consultants	270.0	0.0	270.0
ii. Domestic Consultants	0.0	27.0	27.0
b. International and Local Travel	15.0	6.0	21.0
c. Reports and Communications	5.0	5.0	10.0
2. Translation	0.0	9.0	9.0
3. Training, Seminars, and Conferences	0.0	5.0	5.0
4. Miscellaneous Administration and Support Costs	5.0	5.0	10.0
5. Contingencies	38.0	10.0	48.0
Subtotal (A)	333.0	67.0	400.0
B. Government Financing			
1. Office Accommodation and Transport	0.0	25.0	25.0
2. Remuneration and Per Diem of Counterpart Staff	0.0	30.0	30.0
3. Others	0.0	17.0	17.0
Subtotal (B)	0.0	72.0	72.0
Total	333.0	139.0	472.0

Source: Asian Development Bank estimates.

OUTLINE TERMS OF REFERENCE

A. International Insurance Expert (9 person-months)

1. The expert must have extensive working knowledge of supervision and prudential regulation of the insurance business, and international best practices. At the current development stage of the Cambodia insurance markets, experience in nonlife insurance is essential for this position. The expert should also demonstrate good understanding of the history and culture of Cambodia insurance markets and the legal and regulatory system on which the insurance industry is based.

2. The expert will work as a resident advisor, helping the director and other staff members of the Financial Industry Department (FID) in day-to-day insurance supervision, prudential regulations, and policymaking. The expert is expected to work in FID during official business working hours to report his or her daily activities to ADB in the agreed-on format every month.

3. The expert will also undertake the following tasks:

- (i) Design a medium-term development plan to upgrade the legal and supervisory framework for insurance and develop the insurance industry. The plan should include (a) a diagnostic review of the legal and regulatory framework for the insurance sector, and of the insurance industry; (b) an insurance supervisory framework, including on-site inspection and off-site surveillance based on International Association for Insurance Supervisors principles; (c) policyholder protection (e.g., creation of a policyholder protection fund); (d) insurance and reinsurance accounting; and (e) intermediaries such as brokers and agents.
- (ii) Formulate manuals and procedures for off-site surveillance and on-site inspection of insurance companies.
- (iii) Design and formulate insurance industry statistics consistent with the Association of Southeast Asian Nations (ASEAN) United Forms of Statistics.
- (iv) Help Ministry of Economy and Finance (MEF) implement regulations on accounting standards consistent with ASEAN standards.
- (v) Formulate a restructuring strategy and plan for CAMINCO and Cambodia Re, and help MEF implement the plan in a transparent manner.
- (vi) Design a capacity-building program for MEF's Insurance Division, including staff qualifications, job descriptions, competitive compensation scheme, training needs and timetable, potential training providers, and cost estimation.
- (vii) Train MEF officials and the private sector in regional integration of the insurance regulator and industry to prepare Cambodia to become a member of International Association for Insurance Supervisors and the World Trade Organization (WTO).

B. Domestic Consultant—Economist (9 person-months)

4. The consultant will have a background in economic analysis, understand the insurance business, and be proficient in English. Preferably, the economist will have experience with international organizations. The economist will have the following tasks:

- (i) Help the international team of experts in all aspects of their tasks within the terms of reference.
- (ii) Gather and analyze required information and data, and make them available in English and in an organized, readable form for the international team of experts.
- (iii) Support FID's daily tasks under the guidance of the international consultant.
- (iv) Conduct research on specific topics as required by the team leader.
- (v) Help the international consultant with workshops and seminars.
- (vi) Provide logistical support, including translation and meeting arrangements, among others.