

**REPORT AND RECOMMENDATION
OF THE
PRESIDENT
TO THE
BOARD OF DIRECTORS
ON A
PROPOSED LOAN AND TECHNICAL ASSISTANCE GRANT
TO THE
KINGDOM OF CAMBODIA
FOR
SUBPROGRAM III
OF THE
FINANCIAL SECTOR PROGRAM**

August 2005

CURRENCY EQUIVALENTS

(as of 15 August 2005)

Currency Unit	–	riel (KR)
KR1.00	=	\$0.000248756
\$1.00	=	KR4,020

ABBREVIATIONS

ACLEDA	–	Association of Cambodian Local Economic Development Agencies
ADB	–	Asian Development Bank
CBS	–	center for banking studies
FIU	–	financial intelligence unit
FSPL	–	Financial Sector Program loan
GDP	–	gross domestic product
IAS	–	international accounting standards
IMF	–	International Monetary Fund
ISA	–	international standards of auditing
KICPAA	–	Kampuchea Institute of Certified Public Accountants and Auditors
MEF	–	Ministry of Economy and Finance
MOC	–	Ministry of Commerce
NAC	–	National Accounting Council
NBC	–	National Bank of Cambodia
SDR	–	special drawing rights
TA	–	technical assistance

NOTE

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

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LOAN AND PROGRAM SUMMARY

Borrower	Kingdom of Cambodia
The Proposal	<p>The proposal comprises (i) a loan of special drawing rights equivalent to 6,763,000 (\$10 million) for subprogram III of the Financial Sector Program loan (FSPL), and (ii) a technical assistance (TA) grant for \$0.5 million to support implementation of subprogram III. The FSPL takes a cluster approach and consists of three back-to-back subprograms. Each succeeding subprogram was to be processed sequentially upon completion of the preceding subprogram.</p>
Classification	<p>Targeting classification: General intervention Sector: Finance Subsector: Finance sector development Themes: Sustainable economic growth and governance Subthemes: Promoting economic efficiency and enabling markets, and financial and economic governance</p>
Environment Assessment	<p>Category C. The environmental implications were reviewed and no significant adverse impact was identified.</p>
Social Sector Assessment	<p>Involuntary resettlement: Category C. Impact on indigenous people: Category C. No involuntary resettlement or impact on indigenous people is expected from program implementation.</p>
The Program Rationale	<p>Cambodia's financial sector is at a rudimentary stage with limited financial intermediation and low public confidence. The underdeveloped financial system is one of the most significant constraints faced by the Government in achieving broad-based sustainable economic growth and socioeconomic development objectives, including poverty reduction. Financial sector development has been hampered by numerous constraints: (i) high risk related to uncertainties regarding law and contract enforcement due to a weak rule of law, (ii) high information costs stemming from lack of common accounting and auditing standards and other information infrastructure, (iii) high operating costs due to the absence of liquidity management mechanisms and other market infrastructure, and (iv) weak supervisory systems and capacity.</p> <p>The FSPL supports the Government's efforts to address these constraints and lay the foundation for financial sector development. A sound, efficient, and integrated financial system is crucial for achieving broad-based sustainable economic growth and reducing poverty by increasing job opportunities, lowering transaction costs of economic activities, and extending outreach of the formal financial sector to the poor and rural areas. An efficient financial</p>

system will promote private sector development as well as foreign direct investment. Further, a robust financial sector will protect the economy from unfavorable exogenous shocks that are becoming more common in increasingly globalized financial markets.

Progress under subprograms I and II warrants the support of subprogram III.

Objective and Scope

The FSPL aims to promote the development of a sound, market-based financial system to support resource mobilization and sustainable economic growth by establishing a foundation for the banking and insurance industries as well as financial markets. The FSPL focuses on the following activities:

- (i) Enhance bank intermediation and public confidence by establishing and strengthening banking supervision, developing key information infrastructure and safety nets, and building capacity in both public and private sectors by reinforcing capacity-building institutions.
- (ii) Establish legal and regulatory frameworks for insurance development by institutionalizing a supervisory system and prudential regulations, fostering private sector development in the insurance business, and developing compulsory insurance.
- (iii) Prepare the foundation for developing interbank and money markets by building public-private sector partnerships and establishing a basic legal framework.
- (iv) Develop financial market infrastructure by establishing common accounting standards and enforcement mechanisms, and promulgating laws to underpin commercial activities and financial markets.

Given the progress achieved under subprograms I and II, subprogram III includes the following key initiatives:

- (i) Enhance banking infrastructure by adopting a secured transaction law, establishing a public registry for secured transactions, and establishing a financial intelligence unit responsible for anti-money laundering and combating the financing of terrorism. This will promote and maintain principles of transparency and accountability through the attainment of international standards to minimize the money laundering risk by implementing a robust compliance and monitoring regime.
- (ii) Enact commercial laws and building capacity by (a) adopting commercial arbitration legislation; (b) submitting an insolvency law to the National Assembly; (c) disseminating commercial laws via the Internet, and helping develop commercial law curriculum including

the training of judges, lawyers, and legal staff in the new commercial laws; (d) improving the framework for the insurance subsector by strengthening supervision and prudential regulations through adoption of necessary procedures and building overall capacity of the insurance regulator; and (e) enhancing the competitiveness of the insurance market by restructuring a public sector insurance company and divesting its ownership to the private sector.

- (iii) Prepare the foundation for interbank and money markets by adopting legislation on negotiable instruments and payment transactions, implementing the negotiable instruments and payment transactions law through appropriate regulations, and training staff.
- (iv) Develop accounting and auditing practices by assisting the professional association in training professional members to required accreditation levels.

Loan Amount and Terms A loan of SDR6,763,000 (\$10 million) will be provided from ADB's Special Funds resources. The loan will have a 24-year term including a grace period of 8 years, and an interest rate of 1.0% per annum during the grace period and 1.5% per annum thereafter.

Program Period and Tranching The loan will be released in one tranche upon fulfillment of all specified tranche conditions. Subprogram III will be implemented over 18 months.

Executing Agency The National Bank of Cambodia (NBC) will continue to be the Executing Agency, and the Ministry of Economy and Finance (MEF) and the Ministry of Commerce (MOC) the implementing agencies for subprogram III. To coordinate program implementation among government ministries and agencies concerned, a financial sector steering committee was formed. Chaired by the NBC governor, the committee comprises senior officers from MEF, MOC, NBC, and other government agencies concerned. The committee will meet every quarter and on an ad-hoc basis to review pending issues and propose concrete actions for their resolution, thus ensuring timely program implementation. A senior NBC officer, appointed program director, will continue to assist ADB, NBC, MEF, and MOC in coordinating day-to-day program implementation.

Procurement The loan proceeds will be used to finance the full foreign exchange costs (excluding local duties and taxes) of items produced and procured in ADB member countries, excluding ineligible items and imports financed by other bilateral and multilateral sources. In accordance with the provisions of ADB's *Simplification of Disbursement Procedures and Related Requirements for Program Loans*, the proceeds of the program loan will be disbursed to

Cambodia as the Borrower. No supporting import documentation will be required, if during each year that loan proceeds are expected to be disbursed, the value of Cambodia's total imports minus imports from nonmember countries, ineligible imports, and imports financed under other official development assistance is equal to or greater than the amount of the loan expected to be disbursed during such year. The Government will certify its compliance with this formula with each withdrawal request. Otherwise, import documentation under existing procedures will be required. ADB reserves the right to audit the use of loan proceeds and verify the accuracy of the Government's certification.

Counterpart Funds

The policy framework for the Program includes specific components that bear distinct costs of structural adjustments. The counterpart funds to be generated from loan proceeds will be used to finance the structural adjustment costs arising from the FSPL.

Risks and Safeguards

The principal risks associated with subprogram III relate to the number of bills that require passage by the National Assembly. The bills have the active support of the ministries concerned and NBC. These agencies have undertaken to explain the bills to the legislators and are working closely with the key legislators in the concerned committees so that they understand the important role each legislation will play. In addition to the strong support of the sponsoring government agencies, most of the bills are at an advanced stage of consideration by the National Assembly. In June 2005 an amendment to the constitution reduced the required number of National Assembly members needed to constitute a quorum for the purpose of passing a law—from 87 to 74 members. This should help speed up the passage of laws.

The establishment of institutions such as the NBC financial intelligence unit and upgrading of the insurance regulator are subject to the availability of funding and the commitment of the officials and agencies concerned. Most of these institutional developments will be supported through budgetary allocations, at least in part from counterpart funds under the Program. In addition, these activities will be supported through technical assistance (TA) attached to subprogram III or from other development partners. All of these proposals have the strong backing of the government agencies concerned and are not reliant solely on the support from individual officers.

The implementation results achieved under subprograms I and II underscore the belief that these risks are manageable.

Technical Assistance

ADB will provide TA (\$0.5 million) to support NBC, MEF, and MOC in implementing the various policy and institutional reforms under subprogram III. The main TA activities include (i) technical support to NBC in its efforts to improve its on-site supervision and surveillance of banks; (ii) technical support to MEF to help with its

efforts to strengthen the capacity of the insurance regulator and the restructuring of the state-owned insurance company (Caminco); and (iii) technical support to MOC in its efforts to implement commercial laws and associated regulations.

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed loan to the Kingdom of Cambodia for subprogram III of the Financial Sector Program. The report also describes proposed technical assistance (TA) for Financial Sector Program Implementation, and if the Board approves the proposed loan, I, acting under the authority delegated to me by the Board, will approve the TA.

II. BACKGROUND

2. The overall objective of the FSPL is to promote the development of a sound, market-based financial system to enhance resource mobilization and support sustainable economic growth by establishing a foundation for banking and insurance, and developing the financial market. The FSPL adopted a program cluster approach with three subprograms based on ADB's program lending policy. Each succeeding subprogram was to be processed sequentially upon completion of the preceding subprogram.

3. The ADB Board approved subprogram I for \$10 million on 15 November 2001, to be released in two tranches of \$5 million each.¹ Both tranches were fully disbursed by the end of 2002. Subprogram II was approved on 28 November 2002 for \$10 million, again to be released in two tranches of \$5 million each to continue the reform activities under subprogram I.² The Loan Agreement was signed on 11 December 2002 and subprogram II became effective on 21 February 2003. The release of the first tranche was initially scheduled to occur within 6 months of loan effectiveness (August 2003) but because of the national election in 2003 and the 1-year delay in forming the new government, it was rescheduled to May 2005. The second tranche was initially scheduled for release within 12 months of loan effectiveness (February 2004) but similar to the first tranche, the release date was rescheduled to May 2005. The closing date of subprogram II was extended twice from 31 December 2004 to 30 June 2005, and again to 31 December 2005. The latter extension was to allow for internal processing of the Board documents. The revised design and monitoring framework is in Appendix 1, Achievements of Subprograms I and II and Proposed Actions for Subprogram III is in Appendix 6. The summary poverty reduction and social strategy is in Appendix 2.

4. In seeking ADB Board approval of subprogram III, the lessons learned during subprogram II implementation, the status of the agreed policy reform actions, and the readiness of the Government to undertake further reform measures were considered. The program cluster approach provides the opportunity to discuss and refine the proposed policy actions of succeeding subprograms to reflect the Government's achievements, changes in the policy environment, and lessons learned from the previous subprogram. The program cluster approach enhances flexibility and allows more effective design of reform measures in a changing political, economic, and financial environment.

5. To support FSPL implementation, ADB provided three TAs.³ Technical inputs provided through the TAs were indispensable for completing policy actions under subprograms I and II.

¹ 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.

² 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)*. Manila.

³ ADB. 2001. *Technical Assistance to the Kingdom of Cambodia for Capacity Building for Banking and Financial Management*. Manila. ADB. 2002. *Technical Assistance to the Kingdom of Cambodia for Improving Legal*

III. MACROECONOMIC DEVELOPMENTS

6. A slower growth scenario is expected for Cambodia with the cessation of phase IV garment quotas among World Trade Organization members at the end of 2004.⁴ In the early months of 2005, about 20,000 jobs were lost in the garment industry and export prices decreased significantly. Nevertheless, new facilities are being constructed to produce alternative categories of garments to take advantage of the recent announcement of possible safeguard measures by the United States against the People's Republic of China and the internationally competitive local labor market. At the same time, strong growth continues in tourism and construction. The economy is expected to gradually recover from its anticipated slow growth of 2.3% in 2005 up to close to 5% in 2007.⁵

7. The macroeconomic environment has been reasonably well managed and is stable. While the real gross domestic product (GDP) compound growth averaged 4.5% per annum during 2000–2004, consumer price index inflation was constrained to 2.6% per year and the exchange rate for the riel has been broadly stable with a depreciation of less than 1% per year during this period. Budgetary performance improved somewhat in 2004.⁶ Total revenue rose by 1% to 11.3% of GDP in 2004, partly due to one-off revenue collected from tax arrears. The accumulation of arrears was under control resulting in an overall budget deficit of 5.1% of GDP in 2004 compared with a deficit of 6.6% in 2003. This financial stability is derived from the well-managed fiscal and prudent monetary policy given the high dollarization of the economy.

8. Since 2002, much has been achieved in developing governance infrastructure and in preparing for private sector development. The Government has been proactive in undertaking reforms in accounting and auditing practices in the private sector. Cambodia's accession to the World Trade Organization in late 2003 intensified the Government's efforts to introduce new commercial laws and implementing regulations; strengthen the supervision of banks, microfinance institutions, and insurance subsectors; increase international trade; and reform labor and public finance.

9. The formation of a new government on 15 July 2004 represented a major step forward in Cambodia's political development. Notwithstanding the time taken to form the new government, a peaceful process of dialogue ensued, where all outstanding differences between political parties were apparently resolved without recourse to the violence that characterized previous election outcomes. The commune elections of 2002 represented an important step in the comprehensive program of political, administrative, and financial decentralization. Civil society and nongovernment organizations are participating more in various areas of public concern and freedom of the media is progressing.⁷

Infrastructure in the Financial Sector. Manila: and ADB. 2002. *Technical Assistance to the Kingdom of Cambodia for Improving Insurance Supervision*. Manila.

⁴ Cambodia acceded to the World Trade Organization in 2003.

⁵ ADB. 2005. *Asian Development Outlook*. Manila.

⁶ Statement by the International Monetary Fund resident representative in Cambodia on 18 July 2005 and an International Monetary Fund letter of assessment of Cambodia's macroeconomic policies dated 1 August 2005.

⁷ ADB.2005. *Country Strategy and Program (2005–2009): Cambodia*. Manila.

IV. IMPLEMENTATION PROGRESS OF THE FINANCIAL SECTOR PROGRAM

A. Review of Implementation Progress for Subprogram II

10. In line with the FSPL objectives, the Government adopted legal, policy, and institutional measures under subprogram II. Many measures required extensive coordination to ascertain stakeholders' understanding, acceptance, and adoption. By end June 2005, the Government had complied with all eight first tranche conditions and four of the five second tranche conditions. The one remaining second tranche condition requires the formation of a joint venture between the state-owned insurance company (Caminco) and a private insurance company. Discussions for a joint venture with the nominated private sector company, Indochine, broke down when Indochine went into liquidation. The Government demonstrated its commitment to this condition through the following: (i) the Prime Minister has given his support to the privatization of Caminco; and (ii) a public notice was issued inviting expressions of interest from private sector companies to invest in Caminco. Two proposals that were not responsive to the requirements of the public notice were received by the closing date (30 April 2005). The Government's request for a waiver was supported by ADB management on 19 July 2005. The progress report for subprogram II, including recommendations for approval of the waiver and the release of the first and second tranches of subprogram II, were submitted to the Board of Directors for consideration on a no-objection basis on 11 August 2005. Both tranches were released on 30 August 2005.

1. Development of the Banking Subsector Infrastructure

11. Subprogram II of the FSPL supports the development of banking infrastructure by way of three first-tranche conditions and one second-tranche condition that requires NBC to (i) adopt a uniform chart of bank accounts and disclosure rules for commercial banks consistent with international accounting standards (IAS); (ii) apply the uniform chart of bank accounts and disclosure rules for the commercial banks consistent with IAS to the Rural Development Bank and other specialized banks; (iii) ensure that the Center for Banking Studies (CBS) establishes a central banking course for NBC professional staff, including a mandatory training program for entry-level professional staff; and (iv) adopt a guideline for sharing credit information among members of the bankers association and, together with the bankers association, establish such arrangements.

12. As of 31 March 2005, and with TA provided by ADB, all 14 commercial banks and 3 specialized banks including the Rural Development Bank, had complied with implementation of the chart of accounts and disclosure rules consistent with IAS. NBC also issued a *prakas*⁸ on 29 December 2004 requiring all commercial banks and specialized banks to publish their annual audited financial statements beginning 30 June 2005. NBC will continue to monitor compliance with the application of the chart of accounts by all commercial banks and specialized banks through on-site and off-site supervision.

13. On 2 July 2003, CBS introduced an associate degree program, an entry-level training program for new NBC staff, and a managerial training program. By the end of 2004, CBS had trained three separate intakes totaling 254 students, of whom 210 were non-NBC staff. In 2005, CBS revised and upgraded these courses to meet the challenges for developing the banking system. It has a new associate degree program. Following a request from NBC and CBS, ADB

⁸ Khmer name for regulations and/or instructions issued by the governor of the NBC or a Government minister.

fielded a consultant for 1 month, beginning 3 June 2005, to strengthen the capabilities of the trainers and advise CBS on how to achieve financial sustainability in the medium to long term.

14. NBC signed a memorandum of understanding with 16 banks⁹ outlining guidelines for establishing a credit information sharing system on a pilot basis. The arrangement for credit information sharing is aimed at reducing uncertainties surrounding lending operations of commercial and specialized banks, and will enhance financial intermediation. Consultants under the small and medium enterprises TA¹⁰ are developing the operating system plus a code of conduct, expected to be adopted later in 2005, to aid system implementation.

2. Development of Interbank and Money Markets

15. Recent ADB missions recognized the efforts made by NBC in this area. The Prime Minister submitted the draft law on negotiable instruments and payment transactions to the National Assembly on 18 January 2005, thus fulfilling the required condition. Discussions of Committee 2 began in March 2005. Expected to be approved by June 2006, the draft law will provide the legal basis for developing payment systems, introducing new negotiable instruments, and promoting development of a money market.

3. Strengthening of the Legal and Regulatory Framework

16. Subprogram II supported the development of the legal and regulatory framework by way of one first tranche and two second tranche conditions that required (i) adoption of a commercial enterprises law; (ii) submission to the National Assembly of a secured transactions law; and (iii) adoption by MOC of a time-bound action plan to establish a public registry for secured transactions, acceptable to ADB. The National Assembly ratified the draft law on commercial enterprises on 17 May 2005 and the Royal Kram promulgating the law was issued on 19 June 2005. The approved law is the equivalent of a corporation law and provides the legal basis for registered and nonregistered corporations, their shareholders, and management to operate. It includes provisions for the preparation of corporate financial reports, auditing, and the procedures for transfer of shares. This forms part of the necessary prerequisites for the establishment of a securities and exchange market.

17. Early in 2005, MOC submitted the draft secured transactions law to the Council of Ministers, which formally approved it on 10 June 2005. The draft legislation was submitted to the National Assembly with a letter signed by the Prime Minister on 13 July 2005. In response to the tranche condition requiring a time-bound action plan for the establishment of a secured transactions registry, on 6 May 2005 MOC adopted a time-bound action plan (acceptable to ADB) and submitted a proposal with an estimated budget of \$200,000 to MEF to set up the registry. The establishment of the secured transactions registry will facilitate the enforcement of financial contracts and encourage private sector lending activities. ADB will arrange for consultants¹¹ to help MOC and MEF with the procurement for the registry system, including responding to technical questions about specifications and assisting with bid evaluation.

⁹ The only nonparticipating bank is not undertaking general credit extension to individuals and domestic business in Cambodia.

¹⁰ ADB. 2004. *Technical Assistance to the Kingdom of Cambodia for the Small and Medium Enterprise Development Program*. Manila.

¹¹ To be funded from TA 3861-CAM (ADB.2002. *Technical Assistance to the Kingdom of Cambodia for Improving Legal Infrastructure in the Financial Sector*. Manila).

4. Development of the Insurance Subsector¹²

18. Based on the provisions of the insurance law, three interministerial *prakas* were issued on 16 October 2002 with regulations for compulsory insurance of liabilities arising from construction work, public transport accidents, and motor vehicle third party policies. These are the main insurance products available locally in a sector comprising a state-owned insurer (Caminco) and three private companies (Indochine, Asia Insurance, and Forte). The company, Indochine, is now undergoing liquidation. The total premium market (gross) was more than \$10 million in 2004. MEF is presently reviewing model legislation, regulations, and practices in the region with a view to promoting the expansion of the insurance products and the level of businesses in Cambodia.

19. One of the aims of the Program is to restructure the state-owned company (Caminco) through a joint venture arrangement with a private insurance company. MEF made an important step toward restructuring Caminco when it set up a reinsurance company, Cambodia Re, in 2002 and divested the reinsurance function of Caminco. Cambodia Re became a joint venture with a consortium of five international insurance companies in October 2002. The consortium holds 20% of Cambodia Re's shares. The Government envisaged a joint venture between Caminco and a local private insurance firm (Indochine) when subprogram II was being processed, but that did not come about as the private firm became insolvent and entered liquidation. The Government¹³ has continued to strongly support commercialization of Caminco; restructuring will begin under subprogram III.

20. With the Prime Minister's endorsement of the privatization of Caminco in early 2005, MEF issued a public notice inviting expressions of interest from local and international insurance companies to invest in, at most, 49% of the capital shares of Caminco in line with legislative limitations. Two nonresponsive proposals were received by the closing date of 30 April 2005.¹⁴ In light of the foregoing steps, MEF has unsuccessfully made extensive efforts to find a joint venture partner for Caminco. The ADB mission of May 2005 proposed that the process be pursued as part of the restructuring plan for Caminco and the upgrading of the insurance regulator under subprogram III. A short term consultant under the TA for Improving Insurance Supervision (footnote 3) was fielded in early July 2005 to help finalize Caminco's restructuring plan. The appraisal mission of July 2005 reviewed the first draft of the restructuring plan and requested a revision to clearly identify objectives, key actions, and target completion dates.

¹² Two policy actions are required: (i) MEF, in consultation with related ministries, to adopt regulations for the development of compulsory insurance (first tranche); and (ii) MEF to establish a joint venture between the state-owned insurance company and a private company (second tranche).

¹³ The ADB mission of July 2004 discussed and agreed with MEF an action plan that included strict enforcement of the current regulatory framework; rationalization of the legal and regulatory framework focusing on capital, authorization, and accounting disclosure requirements; strengthening the capacity of the insurance regulator; and enforcing regulations equitably on all insurance firms. The action plan has the objective of restoring confidence and integrity in the insurance market. Successful implementation of the plan is expected to complement any joint venture reform activities that may eventuate for Caminco. Implementation of the plan has been monitored closely, but not much progress has been made, raising concerns about the technical capacity of the Department of Financial Industry to implement the plan effectively. Technical support for the insurance regulator is included in the attached TA for subprogram III.

¹⁴ The first proposal was predicated only on majority ownership (or more than 51% of the shares) and was made by a local firm with no prior insurance experience. The second proposal was a general letter from a competitor insurance company with no specific proposal to purchase shares.

5. Development of Accounting and Auditing Practices

21. Subprogram II supported the development of accounting and auditing through two conditions in the first tranche and one condition in the second tranche: (i) the National Assembly will adopt a law on corporate accounts, their audit, and the accounting profession; (ii) MEF will adopt a subdecree requiring the application of IAS and international standards for auditing (ISA) to all companies (including insurance companies) incorporated in Cambodia, and establishing a national accounting council (NAC) to set and interpret standards; and (iii) MEF will establish an association of accountants and auditors that will (a) adopt a code of ethics that complies with requirements of the International Federation of Accountants, and (b) establish committees on education and ethics within the association.

22. With the consistent efforts of MEF, the National Assembly adopted the law covering corporate accounts, their audit, and the accounting profession on 8 July 2002. NAC was established in March 2003 by a subdecree and its members were appointed by the minister of economy and finance. NAC has since adopted 15 accounting standards and 10 auditing standards based on international standards. The subdecree on the creation of the Kampuchea Institute of Certified Public Accountants and Auditors (KICPAA) was adopted on 19 March 2003. On 10 February 2005, NAC proposed the establishment of committees on education and ethics within KICPAA to the minister of economy and finance. *Prakas* no. 199 on the formation of a commission for work, study, and research was issued on 4 April 2005 and *prakas* no. 222 on the formation of a professional ethics commission was issued on 12 April 2005. The subdecree covering the code of ethics for KICPAA was approved by the Council of Ministers on 3 June 2005 and endorsed by the Prime Minister on 17 June 2005. These activities effectively establish the legal and institutional framework to advance accounting and auditing practices in Cambodia.

B. Impact on the Financial Sector

23. The financial sector performance has made satisfactory progress, albeit from a low base. Financial deepening has improved, reflecting the financial stability and increased financial services promoted through institutional reforms supported under the FSPL. Broad money supply (M2) to GDP has risen from 12.8% of GDP in 2000 before the start of the Program to 21.4% of GDP in 2004, a major structural improvement. Credit to the private sector has correspondingly risen from 6.5% of GDP in 2000 to an estimated 9.9% in 2004. Through the relicensing program,¹⁵ 16 banks (including 4 insolvent banks) were closed, 1 was downgraded to a representative office, and the remaining banks were required to strengthen their capital position. All existing banks were well capitalized and relatively liquid at the end of 2004 with an average capital adequacy ratio to risk weighted asset of 35% and a loan to deposit ratio of just under 60%. The financial sector is now playing an increasingly important role in intermediating savings, accelerating investment formation, and providing an increasing range of banking services to the private sector.

24. Confidence in the banking sector appears to be growing as well as appreciation that banking facilities can be profitably expanded to meet the growing demand for banking services. The ANZ (Australia-New Zealand) Bank from Australia has entered into a joint venture with a domestic consortium¹⁶ to open a new commercial bank in Phnom Penh with two branches

¹⁵ Supported by a 3-year International Monetary Fund poverty reduction and growth facility completed in 2002. Under this program, all commercial banks were required to hold at least \$13 million equivalent of capital or a minimum solvency ratio (ratio of capital to the total risk weighted assets) of 20%, subsequently reduced to 15% in 2004.

¹⁶ The consortium is the Royal Group.

opened in August 2005 and the main head-office to be opened in early September 2005. The Vietnam Bank for Agriculture and Rural Development opened a representative office in Phnom Penh on 11 July 2005. The Association of Cambodian Local Economic Development Agencies was established in January 1993 as a national nongovernment organization for micro and small enterprise credit and has since expanded rapidly throughout Cambodia. In December 2001, NBC granted the association a full banking license and by the end of March 2005, the association had 134 offices with 2,285 staff providing full banking services to 126,040 borrowers throughout most of Cambodia.

25. Other nonbank financial services have been slow to develop and are currently in the early stages of development. For example, the insurance industry has been spurred by the new regulations requiring insurance in three mandated areas, including motor vehicles. Nevertheless the market was still only estimated to be about \$10 million of gross premium income in 2004. The market is made up of about 50–60% of motor vehicle premium income with marine and casualty insurance the next largest class. The very modest size of the insurance market reflects the fact that most of commercial insurance is placed off-shore, while most Cambodians have traditionally gone without insurance cover. The absence of contract enforcement through the court system has meant that Cambodians have not relied on formal insurance.

26. While the outreach of banking services expanded during subprogram II, very slow progress has been made in nonbank financial services such as insurance, pension funds, hire-purchase, and leasing. As such the scope for expansion through existing bank as well as nonbank financial services is very large given the relatively small and underdeveloped nature of the financial market. Financial sector development can increasingly contribute to the efficient transformation of savings into productive investments, particularly within the private sector.

C. Lessons Learned

27. Throughout implementation, steady progress has been made in implementing the overall Financial Sector Program and complying with the specified policy conditions in line with program objectives. However, completing policy measures have required significantly more time than originally envisioned in addition to the almost 1-year delay in forming the new National Assembly following the 2003 general election. In drafting laws and supporting rules and regulations, such as the draft commercial enterprises and secured transactions laws, technical inputs were indispensable. The TAs successfully ensured that best practices were incorporated and then consolidated throughout the consultation period to achieve the intended results.

1. Development of Banking Subsector Infrastructure

28. Progress in the development of banking has been significant due to strong NBC ownership. ADB commends NBC's achievements to date and expects these to be reinforced under subprogram III, in particular in the area of banking supervision.

2. Strengthening of the Legal and Regulatory Framework

29. Fostering a solid understanding of the underlying legal concepts and mechanisms for modernizing the financial system and ensuring consultation with all stakeholders, including the private sector, are assessed as having long-term positive impacts on sustainability of program outputs. Given the experience under subprogram II, and specifically the need for consensus building, additional time is required to fulfill policy measures for tranche releases requiring the passage of legislation. The general election of 2003 and the subsequent delay in forming the

new National Assembly were events beyond control that caused delays to the passage of several laws. At the same time, several layers of committees within the Council of Ministers and the National Assembly were overlooked in the proposed timing for adoption of key legislation during program processing.

30. The introduction of the commercial enterprises law will facilitate development of the corporate sector. The introduction of the draft secured transactions law and adoption of a time-bound program for establishing the secured transactions registry will greatly assist companies' access to funding. The proposed negotiable instruments law will promote money market instruments, such as certificates of deposits and short-term treasury bills, and improve the market structure by introducing money brokerage firms to penetrate the segmented banking subsector. However for active secondary trading in the money market to take place, the commercial orientation of NBC, commercial banks, and the private sector must be significantly improved.

3. Development of the Insurance Subsector

31. The insurance subsector is still in its early stage of development. The underlying concepts and business transactions are very new in Cambodia. While the FSPL has had some success in transforming insurance agents to fully functional insurance firms to compete with the state-owned insurance company, the outcome has been mixed. Reorienting the Government's role from sole operator to regulator has not been easy as most staff have had no prior formal training or experience in insurance. This is a process that will take time with ongoing technical guidance. The ADB mission of May 2005 proposed capacity support to help the reform activities in this subsector plus needed implementation and TA support under subprogram III.

4. Development of Accounting and Auditing Practices

32. Under MEF leadership, substantial progress in the development of accounting and auditing practices was achieved. Major contributing factors include the strong commitment of the MEF and NAC, which has contributed to establishing appropriate regulatory and institutional frameworks. However, buy-in from other parts of the Government, including budgetary support for NAC and KICPAA activities and the training of members to reach appropriate qualifications is needed.

V. THE PROPOSED SUBPROGRAM III

A. Revised Policy Actions for Subprogram III

33. Progress with reforms and the Government's growing capacity to implement reforms indicates the need for continued support under subprogram III. In formulating subprogram III, all policy actions proposed under the FSPL cluster concept of three subprograms were revisited in discussions with the Government. That led to certain policy actions being dropped, revised or newly added, reflecting the Government's achievements, evolving policy environment, and lessons learned from subprograms I and II implementation. Relative to the previously proposed policy matrix for subprogram III, three of the seven conditions have been either dropped or deferred for reasons stated in paras. 34-35.

34. Development of a deposit insurance system has been omitted from the proposed revision of the subprogram III policy matrix in view of the direction of developments in Cambodia's banking subsector. This change reflects the outcome of the dialogue with NBC

officials who would have had the responsibility for implementing the system and managing the resulting moral hazards engendered. Ongoing support to bank on-site supervision is aimed at reinforcing the need for bank management to be more vigilant and take responsibility for operating results. In the interest of depositors, banks are now required to publish their audited annual financial reports with effect from June 2005. All banks are highly capitalized, following the International Monetary Fund (IMF) relicensing program in 2000. Further, the development of the draft securities and exchange law could be deferred to a later program considering the very nascent stage of the securities market. The Council of Ministers is discussing a draft law on Government securities to regulate the issuance and management of Government securities before submission to the National Assembly. This will facilitate development of the bond market.

35. A banking institute for private bank staff was established in January 2004 under the administration of the bankers association. ADB supported several short-term training courses. Mekong Private Sector Development Facility staff are overseeing the progress of the institute and guiding the bankers association on how best to sustain training programs offered. Considering this development and progress, the originally proposed policy action is not retained under subprogram III.

36. The legal infrastructure to support the growing body of commercial law sponsored under these subprograms needs to be further developed. The recognition of property rights as reflected in a strong body of commercial law is one essential component for a well-functioning financial sector. Equally important is a robust and independent court system, supported by a well-educated and functioning judiciary and legal profession. An arbitration center for resolving minor commercial disputes will be established following enactment of the law on commercial arbitration. In addition, the capability to enforce those rights that gives the enacted commercial laws their meaning and effect is also required.¹⁷ Similarly an insolvency law is needed to help enforce contractual and property rights.

37. In light of these concerns, the revised subprogram III policy matrix includes measures to (i) develop the legal infrastructure, including substantial capacity building in legal education to train judges and lawyers in new commercial laws; and (ii) disseminate (by MOC) the commercial laws via the Internet. These measures will involve enhancing the law faculties' course offerings in commercial laws for the education of new lawyers and continuing legal education seminars in the application of these new commercial laws for judges, as well as lawyers and other stakeholders.

38. The draft legislation covering anti-money laundering and combating the financing of terrorism, now with the Council of Ministers, will require establishment of a financial intelligence unit (FIU). Experience from other countries has shown that the central bank must gain experience with these operations prior to introducing the law. To commence preparatory work for establishing the FIU, a unit within NBC's banking supervision department will be established following the approval of subprogram III. Staff of this unit will be trained on FIU activities. Once the law is passed the Australian Transaction Reports and Analysis Centre and other development partners will likely be interested in providing implementation support.

¹⁷ From Procter, Carlisle. 2005. *Financial Sector Assessment Paper: Cambodia 2004*. Manila: ADB: "Property rights are indispensable for the development of any market economy. To confidently trade goods or services it is absolutely essential that agents know that 'the person selling it in fact owns it', and that impacts to such ownership will strictly eventuate according to what contracts defined ex-ante. The stronger and clearer property rights are, the more likely it is that trade of goods and services will take place, and that prices will be efficient. It is no coincidence that an effective judicial system, as well as property rights for it to enforce, is a feature of advanced economies."

39. In the insurance subsector, the Government will consolidate the work that commenced under subprograms I and II to restructure and divest its shares in the state-owned insurance company (Caminco). This will enable MEF to focus on its regulatory role. The existing insurance law needs to be revised to allow share ownership beyond 49% of the state-owned insurance and reinsurance companies, and incorporate developments necessary to create new business opportunities. This will be addressed through ongoing policy dialogue with MEF. The attached TA for subprogram III includes consulting support to implement the restructuring plan for Caminco and assist the insurance regulator in performing its functions equitably.

40. Based on these suggested changes, the proposed policy matrix for subprogram III including the expected completion dates is provided in Appendix 3. The policy matrix is in line with the FSPL framework contained in the development policy letter of 4 October 2001 and the Government's approved financial sector blueprint for 2001–2010. IMF is the only multilateral aid agency involved in the financial sector. The ADB mission coordinated closely with IMF during subprogram II implementation and preparation of subprogram III.

B. Progress with Policy Reform

41. **Secured Transactions Law.** Following formal approval by the Council of Ministers on 10 June 2005, the draft law was submitted to the National Assembly together with a letter signed by the Prime Minister on 13 July 2005. The National Assembly is in recess until 22 August 2005. MOC will, in consultation with the chairperson of Committee 9, determine when to begin discussion. The draft law contains 55 articles, subdivided into 5 chapters.

42. **Public Registry for Secured Transactions.** MOC approved a time-bound action plan for establishing the registry on 6 May 2005. ADB will provide TA (footnote 3) to help procure hardware and software and establish the online registry.

43. **Financial Intelligence Unit.** The draft law for anti-money laundering and combating the financing of terrorism is with the Council of Ministers and several articles have been reviewed in July 2005. Under the attached TA for subprogram III, ADB will provide consulting support to help establish the FIU. The Australian Transaction Reports and Analysis Centre is planning to provide software support to the FIU and train staff on its application.

44. **Law for Commercial Arbitration.** Drafted in 1995 with support from the Canadian International Development Agency, the law was submitted to the National Assembly together with the Commercial Enterprises Law in 2004. It is now with the Committee 9 of the National Assembly awaiting discussion. The National Assembly is in recess until 22 August 2005. MOC will, in consultation with the chairperson of Committee 9, determine when to commence discussion. The draft law contains 47 articles, subdivided into 11 chapters.

45. **Insolvency Law.** Drafted in 2002 with IMF support and submitted to the Council of Ministers in 2003, the draft law has gone through three interministerial debates. Fifteen of the 70 articles have been reviewed. Strong collaboration between MOC and the Ministry of Justice is required to ensure coherence and consistency with the draft civil code. The Ministry of Justice is reviewing the legal procedures and some of the definitional issues. It will take time to get this through the interministerial level before debate by the Council of Ministers.

46. **Dissemination of Commercial Laws.** MOC is ready to post all laws adopted to date, but is constrained by the capacity of its website. MOC has requested budget support from MEF.

MOC is providing official copies of legislation for uploading onto the Internet: www.worldLII.org¹⁸ (World Legal Information Institute).

47. **Commercial Law Curricula Based on the New Commercial Laws.** Under the attached TA for subprogram III, ADB will provide consultant support to help MOC work with relevant law institutes to develop and adopt commercial law curricula for training judges, lawyers, and legal and clerical staff, based on the new commercial laws. MOC is undertaking roadshows in the provinces to raise public awareness of the new commercial laws.

48. **Prudential Regulations to Enhance Solvency, Liquidity and Corporate Governance.** Under the attached TA for subprogram III, ADB will provide consultant support to help MEF review, update, and implement appropriate prudential regulations to enhance solvency, liquidity, and corporate governance requirements; and support the insurance regulator.

49. **Restructure CAMINCO.** MEF has approved the restructuring plan for Caminco that was submitted by the Caminco Board of Directors. Under the attached TA for subprogram III, ADB will provide consultant support to help MEF implement key activities of this plan and divest the Government's shares at the earliest opportunity.

50. **Law on Negotiable Instruments and Payment Transactions.** The draft law was submitted to the National Assembly with a letter from the Prime Minister dated 18 January 2005. At the end of May 2005, Committee 2 of the National Assembly had reviewed three chapters.

51. **Implementing Regulations for the Law on Negotiable Instruments and Payment Transactions.** NBC will finalize details of an IMF TA to help draft the implementing regulations for this law. Under the attached TA for subprogram III, ADB will provide support to help NBC publicly disseminate information on the new law and its implementing regulations.

52. **Scholarships for Development of Professional KICPAA Members.** The Government has been providing 70 scholarships annually since 2003 to train candidates to reach the KICPAA accreditation level. MEF is expected to use funds from the subprogram III loan proceeds to ensure this continues.

C. Loan Amount and Tranching

53. The Government of Cambodia has requested a loan equivalent to SDR6,763,000 (\$10 million) from the Special Funds resources to help finance subprogram III of the Financial Sector Program. The loan will have a 24-year term including a grace period of 8 years, an interest rate of 1.0% per annum during the grace period and 1.5% per annum thereafter, and such other terms and condition set forth in the draft loan and program agreements. The Government has provided ADB with (i) the reasons for its decision to borrow under the Special Funds resources on the basis of these terms and conditions, and (ii) an undertaking that these choices were its own independent decision and not made in reliance on any communication or advice from ADB. The loan will be released in a single tranche upon satisfactory compliance with all tranche conditions. The implementation period for subprogram III is proposed to be 18 months from loan effectiveness.

¹⁸ This webpage is part of ADB RETA 5820. (ADB. 1998. *Regional Technical Assistance for Development of the Internet for Asian Law*. Manila).

54. If an international bank requires credit enhancement prior to investing in the financial sector, ADB may be in a position to provide the investor with a guarantee, based on the FSPL objectives. Any guarantee proposed to be provided by ADB will be subject to a separate Board paper.

D. Implementation Arrangement

55. Implementation arrangements adopted for subprograms I and II have been effective. Although weaknesses in Cambodia's public financial management systems have high costs in terms of allocation and operational efficiency and have resulted in high levels of fiduciary risk to public funds,¹⁹ the Government is committed to a program of reforms identified in the ADB-World Bank *Integrated Fiduciary Assessment and Public Expenditure Review of 2003*. A World Bank program to strengthen public financial management and accountability is expected to be approved by the end of 2005. Given ongoing efforts to strengthen public financial management, and the fact that ADB reserves the right to audit the use of loan funds and to verify the accuracy of the Borrower's certification of compliance, the same procedures for procurement and disbursement of funds and the use of counterpart funds under subprograms I and II, will be applied in subprogram III.

1. Program Management

56. NBC will continue to be the Executing Agency for subprogram III, while MEF and MOC will be the implementing agencies. NBC will continue to be responsible for overall program implementation, including administration and disbursement of loan proceeds, maintenance of accounts, and preparation of quarterly progress reports.

57. To coordinate program implementation among government ministries and agencies concerned, a financial sector steering committee was formed under subprogram I. Chaired by the NBC governor, the committee comprises senior officers from MEF, MOC, NBC, and other government agencies concerned. Under subprogram III, the committee will meet every quarter and on an ad-hoc basis to review pending issues and propose concrete actions to resolve them, thus ensuring timely program implementation. A senior NBC officer, appointed as program director under subprograms I and II, will continue to assist ADB, NBC, MEF, and MOC, in coordinating day-to-day program implementation under subprogram III.

2. Monitoring

58. ADB, jointly with NBC, MEF, and MOC, will continue to conduct quarterly reviews to assess progress in subprogram III implementation and in particular to confirm compliance with tranche conditions. The Government and ADB will continue to engage in active policy dialogue on sector issues, reforms, and other measures; and agree on actions necessary to keep subprogram III on course.

3. Procurement and Disbursement

59. The loan proceeds will be used to finance the full foreign exchange costs (excluding local duties and taxes) of items produced and procured in ADB member countries, excluding ineligible items (Appendix 4) and imports financed by other bilateral and multilateral sources. In

¹⁹ World Bank. 2005. Concept Note for *Cambodia Public Financial Management and Accountability Project*. Washington D.C.

accordance with the provisions of ADB's *Simplification of Disbursement Procedures and Related Requirements for Program Loans*, the proceeds of the program loan will be disbursed to Cambodia as the Borrower. No supporting import documentation will be required, if during each year that loan proceeds are expected to be disbursed, the value of Cambodia's total imports minus imports from nonmember countries, ineligible imports, and imports financed under other official development assistance is equal to or greater than the amount of the loan expected to be disbursed during such year. The Government will certify its compliance with this formula with each withdrawal request. Otherwise, import documentation under existing procedures will be required. ADB reserves the right to audit the use of loan proceeds and verify the accuracy of the Government's certification.

VI. TECHNICAL ASSISTANCE

60. The attached TA will support NBC, MEF, and MOC in implementing the various policy and institutional reforms under subprogram III. The main activities of the TA include (i) technical support to NBC in its efforts to improve its on-site supervision and surveillance of banks, (ii) technical support to MEF to help in its efforts to strengthen the capacity of the insurance regulator and restructuring of the state-owned insurance company (Caminco), and (iii) technical support to MOC in its efforts to implement commercial laws and associated regulations.

61. The TA is estimated to cost a total of \$650,000 equivalent, comprising foreign exchange costs of \$435,000 and local currency costs of \$215,000 equivalent. ADB will provide \$500,000 on a grant basis from its TA funding program to finance the entire foreign exchange cost plus \$65,000 equivalent of the local currency cost. The Government will finance the remaining \$150,000 equivalent of the local currency costs, which include the provision of counterpart staff, office space, administrative support, and other miscellaneous services. ADB will engage individual consultants to provide consulting services for a total of 29.5 person-months (15.5 person-months of international and 14 person-months of domestic consulting inputs). The consultants will be engaged by ADB on an individual basis (consultants from related fields of expertise are to be recruited through a firm) in accordance with the *Guidelines on the Use of Consultants by Asian Development Bank and Its Borrowers* and other arrangements satisfactory to ADB for the engagement of domestic consultants. The TA purpose, outputs, methodology, implementation arrangements, terms of reference of consultants, and budget are in Appendix 5.

VII. ASSURANCES

A. Specific Assurances

62. In addition to the standard assurances, the Government has given the following assurances, which are incorporated in the legal documents:

- (i) The policies adopted and actions taken before the date of the Loan Agreement of subprogram III as described in the Financial Sector Program development policy letter will continue in operation.
- (ii) The Government will promptly adopt the policies and actions included in subprogram III and specified in the Financial Sector Program development policy letter, and will ensure that such policies and actions continue in operation.

B. Conditions for Disbursement

63. The disbursement of the single tranche under subprogram III is subject to compliance with all the specified tranche conditions and satisfactory implementation of the overall Financial Sector Program, as set out in the policy matrix.

VIII. RECOMMENDATION

64. I am satisfied that the proposed loan would comply with the Articles of Agreement of ADB and recommend that the Board approve the loan in various currencies equivalent to Special Drawing Rights 6,763,000 to the Kingdom of Cambodia for subprogram III of the Financial Sector Program from ADB's Special Funds resources with an interest charge at the rate of 1.0% per annum during the grace period and 1.5% per annum thereafter; a term of 24 years, including a grace period of 8 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft Loan Agreement presented to the Board.

Haruhiko Kuroda
President

30 August 2005

Design and Monitoring Framework ^a–Financial Sector Program

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
Goal Develop a sound, market-based financial system to support resource mobilization and sustainable economic Growth.	Increased M2/gross domestic product (GDP) Increased financial assets/GDP ratio Increased capital adequacy and bank profitability Reduced level of nonperforming assets Tightened interest rate spread Diversified financial services Enhanced rural financial services Diversified insurance products Increased interbank market activities Established legal basis for capital market development	Economic reports, official statistics Asian Development Bank (ADB) review missions	
Purpose 1. Enhance banking intermediation, public confidence, and capacity building. 2. Establish legal and regulatory framework for insurance development. 3. Lay foundation for the development of interbank/money markets. 4. Create an enabling environment for capital market development. 5. Develop financial Infrastructure.	Strengthened banking supervision Developed core information infrastructure and safety net Strengthened human capacity in public and private sectors Strengthened insurance supervisory system and prudential regulations Private sector development in the insurance sector Development of compulsory insurance enforcement/monitoring mechanism Establishment of basic legal framework for inter-bank/money markets Establishment of legal system Establishment of accounting/auditing standards and enforcement mechanism	Official copies of laws, decrees, regulations, etc. from the National Bank of Cambodia (NBC) and the Ministry of Economy and Finance (MEF) Reports of various financial institutions ADB review missions	The Government's financial sector strategy is Implemented. Macroeconomic stability continues. Political commitment to undertake the reforms continues. NBC, MEF, Ministry of Commerce (MOC), and all stakeholders remain committed. Capacity to undertake the reforms is present. Implementation of governance reforms is as specified in the Governance Action Plan.

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
Subprograms A. Subprogram I 1. Banking subsector a. Strengthening bank supervision/prudential regulations	<p>NBC to reconcile old prudential regulations with new regulations and issue clarifying guidance to commercial banks</p> <p>NBC to fully staff the on-site inspection division of the Banking Supervision Department, acceptable to ADB</p> <p>NBC to adopt a formal procedure for soliciting comments from the private sector on proposed or revisions to laws, regulations, procedures, and policies affecting banking subsector</p> <p>NBC to adopt surveillance and inspection procedures including standardization of reports submitted by commercial banks; unless specified otherwise in the NBC regulations, these procedures are also to be applied to licensed microfinance institutions</p> <p>NBC to adopt a prompt corrective action system for commercial banks, acceptable to ADB; a similar system is to be applied to licensed microfinance institutions with modified capital adequacy standards</p> <p>NBC to adopt an anti-money laundering regulation; unless specified otherwise in the NBC regulations, this regulation is also to be applied to licensed microfinance institutions</p>	<p>Official copies of effective prudential regulations and the clarifying guidance</p> <p>Official copies of organization chart of the Banking Supervision Department, job descriptions, and NBC decision regarding staff appointment</p> <p>Official copy of the procedure for soliciting comments from the private sector</p> <p>Official copy of the surveillance and inspection procedures</p> <p>Official copy of NBC regulations on prompt corrective action system</p> <p>Official copy of the anti-money laundering regulation</p>	<p>NBC is committed to the reform.</p> <p>NBC is willing to communicate with the private sector.</p>
b. Capacity building	<p>NBC to establish a center for banking studies (CBS) as a subsidiary of NBC with separate management and accounts</p> <p>NBC to ensure that Foreign Trade Bank (FTB) management adopts a comprehensive staff training program, including accounting, risk management, asset/liability management, and a management information system</p>	<p>Official copy of the NBC decision to establish CBS as a subsidiary</p> <p>Confirmation letter from FTB management with official copy of the training program and budget approved by FTB board</p>	<p>NBC and FTB management are committed to these activities.</p>

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
2. Insurance subsector Establishing supervisory/regulatory framework for insurance development	MEF to establish an insurance supervisory unit MEF to ensure issuance of a subdecree to implement the Insurance Law	Official copy of the MEF regulation to establish the insurance supervisory unit Official copy of personnel announcement Official copy of the subdecree	MEF is commitment to process. Capacity is built in the insurance supervisory unit.
3. Money/interbank markets Creating interbank market arrangements	NBC to recognize bankers association as a self-regulatory organization Approved articles of association must include provisions for the establishment of interbank market arrangements, arrangements for sharing credit information among the members of the bankers association, and a banking institute for private bank staff NBC and the bankers association to establish a working group to establish interbank market arrangements, arrangements for sharing credit information among the members of the bankers association, and a banking institute	Official copy of the articles of association approved by NBC Confirmation letter from NBC with official copy of the document establishing the interbank markets working group	NBC and The commercial banks are committed to the process. Collaboration of NBC and commercial banks
4. Accounting and auditing and legal infrastructure	MEF to submit to the National Assembly a draft law on corporate accounts, their audit, and the accounting profession MEF to adopt international accounting standards (IAS) and international standards for auditing (ISA) to be applied upon the adoption of the law on corporate accounts, their audit, and the accounting profession MOC to submit to the National Assembly a draft law on commercial enterprises	Official copy of the draft law on corporate accounts, their audit, and the accounting profession submitted to the National Assembly Confirmation letter from MEF to adopt IAS and ISA Copy of the draft law on commercial enterprises submitted to the National Assembly	The Government is committed to establishing and enforcing the accounting standards The Government is committed to the reform.
B. Subprogram II 1. Banking Subsector a. Developing	NBC to adopt a guideline for the	Official copy of the	NBC is committed to

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
banking subsector infrastructure and safety net	<p>arrangements for sharing credit information among the members of the bankers association; NBC and the bankers association are to establish such arrangements</p> <p>NBC to adopt a uniform chart of bank accounts and disclosure rules for the commercial banks consistent with IAS</p> <p>NBC to apply the uniform chart of bank accounts and disclosure rules for the commercial banks, consistent with IAS, to the Rural Development Bank, and other specialized banks</p> <p>MOC to submit to the National Assembly a draft secured transactions law</p> <p>MOC to adopt a plan to establish a public registry for secured transactions acceptable to ADB</p>	<p>guideline</p> <p>Official copy of a uniform chart of accounts and disclosure rules for banks</p> <p>Official copy of the clarifying regulation to apply the uniform chart of bank accounts and disclosure rules for the commercial banks to the Rural Development Bank and other specialized banks</p> <p>Official copy of the draft secured transactions law submitted to the National Assembly</p> <p>Confirmation letter of adoption of the plan from MOC, and official copy of plan to establish a public registry</p>	<p>activities.</p> <p>Minimizing costs of non-compliance</p> <p>MOC is committed to the reforms.</p>
b. Capacity building	NBC to ensure that CBS establishes a central banking course for NBC professional staff, including a mandatory training program for entry-level professional staff	Confirmation letter from NBC, and official copy of the CBS curriculum	NBC is committed to systematic capacity building.
2. Insurance Subsector			
a. Establishing framework for compulsory insurance	MEF, in consultation with related ministries, to adopt interministerial regulations for development of compulsory insurance	Confirmation letter from MEF, and official copy of the compulsory insurance regulations	Capacity is built in the insurance supervisory unit.
b. Promoting private sector development	MEF to establish a joint venture between the state-owned insurance company and a private insurance company	Official copy of the joint venture agreement and articles of incorporation	
3. Interbank/Money Markets	NBC to submit to the National Assembly a draft law on negotiable instruments and payment transactions	Official copy of the draft law on negotiable instruments and payment transactions submitted to the National Assembly	NBC is committed to the reform.
4. Accounting and Auditing System and Legal Infrastructure	<p>Adoption of a law on corporate accounts, their audit, and the accounting profession</p> <p>MEF to adopt a subdecree to apply IAS and ISA to all</p>	<p>Official copy of law on corporate accounts, their Audit, and the accounting Profession; and official copy of the official gazette announcing the adoption</p>	<p>MEF has the capacity to enforce IAS and ISA.</p> <p>Compliance costs for the private sector are manageable.</p>

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
	<p>companies (including insurance companies) incorporated in Cambodia, and to establish a national accounting council to set and interpret standards</p> <p>Adoption of a law on commercial enterprises</p> <p>MEF to establish an association of accountants and auditors including</p> <p>(a) adopting a code of ethics that complies with the requirements of the International Federation of Accountants, and</p> <p>(b) establishing committees on education and ethics within the association</p>	<p>Official copy of the subdecree</p> <p>Copy of the law on commercial enterprises, and copy of the official gazette announcing the adoption</p> <p>Official copy of the articles of association for the association of accountants and auditors</p> <p>Official copy of code of ethics</p>	<p>MEF is committed and has adequate capacity.</p> <p>MEF is committed to the reform.</p>
<p>C. Subprogram III</p> <p>1. Development of the Banking Subsector</p> <p>a. Development of banking subsector infrastructure</p>	<p>Adoption of a secured transactions law by the National Assembly</p> <p>MOC to establish a public registry for secured transactions</p> <p>NBC to form a unit and undertake the preparatory work needed to establish a financial intelligence unit responsible for anti-money laundering and combating the financing of terrorism</p>	<p>Official copy of the secured transactions law, and a copy of the Royal Kram promulgating the law</p> <p>Ministerial <i>prakas</i> to establish the public registry and confirmation by MOC of its commencement</p> <p>(i) NBC confirmation that the unit (the precursor to the financial intelligence unit) is established, the mandate of the unit and staff terms of reference.</p> <p>(ii) Documentation for the financial intelligence unit indicating: organization chart; staff terms of reference; budget allocation; procedures to capture and report on suspicious transactions and know your customer; training and public awareness programs</p>	<p>Assumptions</p> <p>MOC is committed, committee number 9 of the National Assembly endorses the draft law, and the National Assembly has the required quorum to approve the law without delay.</p> <p>NBC is committed to the reform.</p>
<p>b. Commercial law development and capacity building</p>	<p>Adoption of a law for commercial arbitration by the National Assembly</p>	<p>Official copy of the approved law on commercial arbitration and a copy of the Royal Kram</p>	<p>MOC is committed, Committee 9 of the National Assembly endorses the draft law, and the National</p>

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
2. Development of the Insurance Subsector a. Strengthening capacity of the regulator b. Promoting private sector involvement in the insurance sector	Submission of an insolvency law to the National Assembly	<p>promulgating the law</p> <p>Letter from the MOC confirming approval of the draft insolvency law by the Council of Ministers and submission to National Assembly, and a copy of the approved draft insolvency law with the accompanying letter from the Prime Minister or authorized person to the National Assembly</p>	<p>Assembly has the required quorum to approve the law without delay.</p> <p>Assumptions</p> <p>MEF is committed to the reform.</p> <p>The Government is committed to the reform.</p>
	MOC to ensure dissemination of commercial laws via the Internet	Letter from MOC confirming the webpage address and list of commercial laws that have been uploaded	
	MOC to work with the relevant law institutes to develop commercial law curricula based on the new commercial laws for training judges, lawyers, and legal clerical staff	Copy of the approved commercial law curricula and confirmation from MOC that training programs have been adopted and are being implemented	
	MEF to review, update, and implement appropriate prudential regulations to enhance solvency, liquidity, and corporate governance requirements and support technical assistance (TA) to the insurance regulator	Progress reports of consultant(s), copies of prudential regulations and internal procedures approved by the MEF minister and 6-monthly progress report from MEF on their implementation	
	MEF to implement the key actions of the plan to restructure Caminco, as agreed with ADB with a view to divest Government's shares at the earliest opportunity	Copy of the approved restructuring plan and MEF letter confirming its implementation and completion of key activities as follows: financial model to be approved by the Board and adopted; enhanced financial disclosure and reporting requirements to be approved by the Board and implemented; evaluation of existing staff finalized and approved by the Board; training needs assessment report; training program developed and being implemented; and annual business plan for 2006 approved by the Board.	

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
3. Development of Interbank and Money Markets a. Legal framework for money market development 4. Development of Accounting and Auditing Practices a. Capacity support to develop professional members for the Kampuchea Institute of Certified Public Accountants and Auditors (KICPAA)	<p>Adoption of a law on negotiable instruments and payment transactions by the National Assembly</p> <p>NBC to draft and adopt implementing regulations for the law on negotiable instruments and payment transactions</p> <p>MEF to ensure financial support for at least 70 scholarships a year for the development of professional members for the KICPAA</p>	<p>Official copy of the approved law on negotiable instruments and payment transactions, and a copy of the Royal Kram promulgating the law</p> <p>Copy of the NBC <i>prakas</i> and/or regulations for implementing the law on negotiable instruments and payment transactions</p> <p>(i) Confirmation letter from MEF of the continuation of the annual budget allocation for 70 scholarships per year (2006 and 2007 fiscal years) to train local candidates to reach the KICPAA accreditation requirements, (ii) selection criteria for scholarship candidates and administrative procedures for scholarship selection to be developed by the KICPAA in consultation with MEF and adopted, (iii) public announcements issued by KICPAA calling for nominees for the 70 scholarships in 2006 and 2007</p>	Assumptions <p>NBC is committed, committee number 2 of the National Assembly endorses the law, and the National Assembly has the required quorum to approve the law without delay.</p> <p>The Government is committed to the reform.</p> <p>MEF is committed to the reform.</p>
D. Technical Assistance Purpose Improve the capacity of the executing and implementing agencies to implement the policy reform activities under Subprogram III	<p>Enhance confidence in banking through improved payment system, on-site supervision, and surveillance.</p> <p>Deter money-laundering activities.</p> <p>Enhance confidence in the insurance market and safeguard policyholders.</p> <p>Enhance understanding of the new commercial legislation and ensure</p>	<p>Published annual audited financial reports of banks</p> <p>Reports to the financial intelligence unit on suspicious transactions</p> <p>Consultants' reports</p> <p>ADB review missions</p> <p>Acceptance of the commercial law training</p>	Assumptions <p>NBC is committed to the reform.</p> <p>MEF and Department of Financial Industry are commitment to the reform.</p> <p>Political will continues to approve key commercial legislations and enhance the judiciary functions to resolve commercial disputes.</p>

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
Outputs a. Supervision of banks and payment system b. Supervision and commercialization of the insurance subsector c. Application of commercial laws Inputs	timely application.	modules by local legal institutions Number of reported commercial cases being successfully resolved	Assumption NBC is committed to the reform.
	Staff trained in the application of procedures for on-site supervision of banks	Progress report from consultants Published bank reports	
	Public awareness, acceptance, and application of the approved law on negotiable instruments and payment transactions	Reports from NBC ADB review missions	
	Financial intelligence unit established		
	New and revised prudential regulations for insurance	Progress reports from consultants	MEF and Department of Financial Industry are committed to the reform.
	Procedures for insurance supervision and training provided to the staff on their application	Published reports of insurance companies	
	Restructured Caminco with part of the Government shares divested	Reports from MEF and Caminco	MEF and Caminco are committed to the reform.
	Training materials on commercial law courses acceptable to local legal faculties	Report from MOC ADB review missions	MOC and the legal faculties are committed to implementing training.
	Commercial disputes being resolved amicably		
	Advisory TA of \$0.5 million from ADB funds and \$0.15 million from the Government to implement key reform activities under subprogram III. The TA will provide 15.5 person-months of international and 14 person-months of domestic consulting services.	Signed TA letter Progress report from consultants ADB review missions Feedback from implementing agencies	Recruitment of qualified and experienced consultants is timely. Implementing agencies take full ownership of the reform activities.

^a The program framework as approved by the Board of Directors in November 2001 and subprogram II, updated and approved by the Board of Directors in November 2002.

SUMMARY POVERTY REDUCTION AND SOCIAL STRATEGY

A. Linkages to the Country Poverty Analysis

Is the sector identified as a national priority in country poverty analysis? <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	Is the sector identified as a national priority in country poverty partnership agreement? <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No
<p>Contribution of the sector or subsector to reduce poverty in Cambodia:</p> <p>The Financial Sector Program loan (FSPL) is expected to increase the efficiency of financial intermediation in Cambodia by promoting the development of a sound, market-based financial system to enhance the potential for economic growth and the creation of employment opportunities. The benefits of the FSPL, including broader access to financial services and a more competitive, diversified financial sector that reduces systemic vulnerabilities, are expected to become substantive with (i) strengthening of the legal infrastructure and accounting system; (ii) capacity building in the banking supervision department of the National Bank of Cambodia, and commercial banks; and (iii) development of the insurance subsector. With environments conducive to the development of the financial sector, supported by (i) effective legal and regulatory reforms; (ii) higher capabilities of the accounting profession; (iii) expansion of credit from the banking subsector to support economic activities; and (iv) the concomitant growth of subsectors such as insurance and microfinance, a wider cross-section of the population will benefit. Beneficiaries are expected to include the poor and near-poor. A broader and more balanced financial system will have higher resilience to external shocks, which have serious implications for the poor.</p>	

B. Poverty Analysis

Targeting Classification: General intervention

The reform measures proposed under the Program have no direct impact on the poor or the vulnerable. No specific element requiring poverty analysis was identified in the Program.

C. Participation Process

Is there a stakeholder analysis? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	Is there a participation strategy? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
All reform measures will undergo substantive stakeholder consultations before implementation. However, no specific elements in the Program require direct participation of citizens.	

D. Gender Development

<p>Strategy to maximize impacts on women:</p> <p>Implementation of reform measures will be gender neutral.</p> <p>Has an output been prepared? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No </p>

E. Social Safeguards and other Social Risks

Item	Significant/ Not Significant/ None	Strategy to Address Issues	Plan Required
Resettlement	<input type="checkbox"/> Significant <input type="checkbox"/> Not significant <input checked="" type="checkbox"/> None	The Program requires no construction or rehabilitation work; is not expected to require land acquisition; and has no potential to endanger loss of assets, resources, or income.	<input type="checkbox"/> Full <input type="checkbox"/> Short <input checked="" type="checkbox"/> None
Affordability	<input type="checkbox"/> Significant <input type="checkbox"/> Not significant	The Program will not affect access to goods and services for the poor or otherwise vulnerable groups.	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No

	<input checked="" type="checkbox"/> None		
Labor	<input type="checkbox"/> Significant <input checked="" type="checkbox"/> Not significant <input type="checkbox"/> None	A restructuring plan for the state-owned insurance company (Caminco) was approved in August 2005. A small number of employees could be made redundant through the restructuring. Consultants to be provided under the attached technical assistance will assist in implementing the restructuring plan and oversee labor-related issues.	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
Indigenous Peoples	<input type="checkbox"/> Significant <input type="checkbox"/> Not significant <input checked="" type="checkbox"/> None	The Program has no component that would impact indigenous people in any way.	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
Other Risks and/or Vulnerabilities	<input type="checkbox"/> Significant <input type="checkbox"/> Not significant <input checked="" type="checkbox"/> None	No social risks were identified in the Program.	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No

POLICY MATRIX FOR SUBPROGRAM III

Objectives	Conditions	Expected Completion Date
Development of the Banking Subsector		
A. Develop Banking Subsector Infrastructure	The National Assembly to adopt a secured transactions law	September 2006
	Ministry of Commerce (MOC) to establish a public registry for secured transactions	March 2006
	National Bank of Cambodia (NBC) to form a unit and undertake the preparatory work needed to establish a financial intelligence unit responsible for anti-money laundering and combating the financing of terrorism ^a	June 2006
B. Develop Commercial Law and Build Capacity	The National Assembly to adopt a law for commercial arbitration ^a	March 2006
	MOC to submit an insolvency law to the National Assembly ^a	April 2006
	MOC to ensure dissemination of commercial laws via the Internet ^a	December 2005
	MOC to work with the relevant law institutes to develop and adopt commercial law curricula based on the new commercial laws for training judges, lawyers, and legal clerical staff ^a	March 2006
Development of the Insurance Sector		
C. Strengthen Capacity of the Regulator	Ministry of Economy and Finance (MEF) to review, update, and implement appropriate prudential regulations to enhance solvency, liquidity, and corporate governance requirements; and support technical assistance to the insurance regulator ^a	June 2006
D. Promote Private Sector involvement in the Insurance Sector		

Objectives	Conditions	Expected Completion Date
	MEF to implement the key actions of the plan to restructure Caminco, as agreed with ADB with a view to divest the Government's shares at the earliest opportunity	August 2006
Development of Interbank and Money Markets		
E. Develop Legal Framework for Money Market	The National Assembly to adopt a law on negotiable instruments and payment transactions	June 2006
	NBC to draft and adopt implementing regulations for the law on negotiable instruments and payment transactions ^a	September 2006
Development of Accounting and Auditing Practices		
F. Provide Capacity Support to Develop Professional Members of Kampuchea Institute of Certified Public Accountants and Auditors (KICPAA).	MEF to ensure financial support for at least 70 scholarships a year for the development of professional members for the KICPAA ^a	April 2006

^a New conditions as proposed

LIST OF INELIGIBLE ITEMS

No withdrawals will be made for

- (i) expenditures for goods included in the following groups or subgroups of the United Nations Standards International Trade Classification, Revision 3 (Table), or any successor groups or subgroups under future revisions as will be designated by the Asian Development Bank by notice to the Borrower:

Group	Subgroup	Description of Items
112	—	alcoholic beverages
121	—	tobacco, unmanufactured tobacco refuse
122	—	tobacco, manufactured (whether or not containing tobacco substitutes)
525	—	radioactive and associated materials
667	—	pearls; precious and semiprecious stones, unworked or worked
718	718.7	nuclear reactors and parts thereof, fuel elements (cartridges), nonirradiated, for nuclear reactors
897	897.3	jewelry of gold, silver, or platinum group metals (except watches and watch cases) and goldsmiths' or silversmiths' wares (including set gems)
971	—	gold, nonmonetary (excluding gold ores and concentrates)

- (ii) expenditures in the currency of the Borrower or of goods supplied from the territory of the Borrower;
- (iii) payment made for expenditures incurred more than 180 days prior to the effective date;
- (iv) expenditures for goods supplied under a contract that any national or international financing institution or agency will have financed or agreed to finance, including any contract financed under any loans from the Asian Development Bank;
- (v) expenditures for goods intended for military or paramilitary purposes or for luxury consumption; or
- (vi) expenditures for pesticides categorized as extremely hazardous or highly hazardous in Class 1a and 1b, respectively, of the World Health Organization's Classification of Pesticides by Hazard and Guidelines to Classification.

THE TECHNICAL ASSISTANCE

A. Purpose and Outputs

1. The primary purpose of the technical assistance (TA) is to help the Government improve the capacity of the National Bank of Cambodia (NBC), the Executing Agency, and the Ministry of Economy and Finance (MEF) and Ministry of Commerce (MOC), the implementing agencies, to implement the policy actions under subprogram III of the Financial Sector Program loan (FSPL). This requires technical inputs and targeted on-the-job support to equip key government agencies such as NBC, MEF, MOC to impart appropriate knowledge and skills to continue the required reforms initiated under subprograms I and II on a sustainable basis.

2. Building on accomplishments under subprograms I and II, the TA will focus on achieving three major outputs in support of the subprogram III policy initiatives:

- (i) **Strengthen supervision of banks and the payment system.** Strengthen the on-site supervision capacity of the bank regulator, support establishment of a financial intelligence unit within NBC to enhance bank surveillance and public confidence, and enhance public awareness and acceptance of the new law on negotiable instruments and payment transactions.
- (ii) **Develop the insurance sector.** Improve the insurance prudential regulations and strengthen the capacity of the insurance regulator within MEF (Department of Financial Industry) to implement those regulations, and assist in implementing a restructuring plan for the state-owned insurance company (Caminco).
- (iii) **Develop commercial law and build capacity.** Provide training support to enhance understanding and application of the new commercial legislation by commercial judges, lawyers, and legal clerks.

B. Methodology and Key Activities

3. The TA consultants will separately provide expertise in the following: (i) supervision of banks and establishment of a financial intelligence unit, (ii) enhancement of awareness of the negotiable instruments and payment transactions regime, (iii) supervision of insurance activities and related training, (iv) restructuring of the state-owned insurance company (Caminco), and (v) provision of training in commercial laws. The banking supervision expert will help (i) develop on-site supervision procedures and on-the-job training of staff on their application, and (ii) establish a financial intelligence unit. The negotiable instruments and payment system's legal expert will undertake public dissemination of the new law and its implementing regulations. The insurance supervision expert will organize one study tour; update the regulatory framework for insurance; and provide on-the-job training to Department of Financial Industry staff on application, documentation, and follow-up and/or corrective actions. The insurance corporate restructuring expert will assist MEF and Caminco in implementing Caminco's restructuring plan. The commercial law expert will be required to develop the commercial law curriculum and training modules to be used by the various legal faculties in Cambodia, and provide seminars on the topic for teachers in the law faculties, judges, practicing lawyers, and judiciary staff with recommendations for ensuring continuity in the training programs. ADB will monitor closely the activities under each component to ensure the quality of outputs and their achievement within the approved resources.

C. Cost and Financing

4. The TA is estimated to cost a total of \$650,000 equivalent, comprising foreign exchange costs of \$435,000 and local currency costs of \$215,000 equivalent. ADB will provide \$500,000 on a grant basis from its TA funding program to finance the entire foreign exchange cost plus \$65,000 equivalent of the local currency cost. The Government will finance the remaining \$150,000 equivalent of the local currency costs including the provision of counterpart staff, office space, administrative support, and other miscellaneous services. The cost estimates and financing plan are in Table A5.

Table A5: Cost Estimates and Financing Plan
(\$)

Item	Foreign Exchange	Local Currency	Total Cost
A. Asian Development Bank Financing^a			
1. Consultants			
a. Remuneration and Per Diem			
i. International Consultants	307,500	0	307,500
ii. Domestic Consultants	0	40,000	40,000
b. International and Local Travel	65,000	5,000	70,000
c. Reports and Communications	5,000	0	5,000
2. Training, Seminars, and Conferences			
a. Study Tour	10,000	0	10,000
b. Seminars/Workshops	0	17,000	17,000
3. Contingencies	47,500	3,000	50,500
Subtotal (A)	435,000	65,000	500,000
B. Government Financing			
1. Office Accommodation and Secretarial Services	0	45,000	45,000
2. Remuneration and Per Diem of Counterpart Staff	0	50,000	50,000
3. Facilities for Seminars/Workshops	0	30,000	30,000
3. Others	0	25,000	25,000
Subtotal (B)	0	150,000	150,000
Total	435,000	215,000	650,000

^a Financed by the Asian Development Bank's technical assistance funding program.

Source: Asian Development Bank estimates.

D. Implementation Arrangements

5. NBC will be responsible for bank supervision and public dissemination of the negotiable instruments and payment transactions regime components, and coordinate TA activities through the financial sector steering committee. MEF will be the Implementing Agency for the insurance component, and MOC the Implementing Agency for the training in commercial law component. NBC, MEF and MOC will provide office space, counterpart staff, and other support services to the consultants.

6. ADB will engage individual consultants to provide a total of 29.5 person-months of consulting services. This will comprise 15.5 person-months of international and 14 person-

months of domestic consulting input. The consultants will be engaged by ADB on an individual basis (consultants from related fields of expertise are to be recruited through a firm) in accordance with the *Guidelines on the Use of Consultants by Asian Development Bank and Its Borrowers* and other arrangements satisfactory to ADB for the engagement of domestic consultants.

7. The consultants will produce an inception, interim, and draft final report for each component. The inception report will be submitted within 3 weeks of the start of services and will contain a time-bound work plan of activities and deliverables. The interim report will be submitted half-way through the contract, and the draft final report submitted at least 3 weeks before completion of the contract. The final report, incorporating comments of the implementing agency and ADB should be submitted upon completion of the services. The TA is scheduled to commence by 1 November 2005 and be completed by 31 March 2007.

E. Outline Terms of Reference for the Consultants

1. International Consultants

a. Banking Supervision Expert¹ (4 person-months, intermittent)

8. The banking supervision expert must have extensive working experience in various areas of banking supervision including on-site supervision and be familiar with international standards and best practices. Familiarity with the existing legal and regulatory framework of the Cambodian banking system will be an advantage. The expert will assist NBC's Department of Supervision during three field visits by enhancing the on-site supervision capacity of its staff. In addition, the expert will undertake the following tasks:

- (i) Review the relevant prudential regulations and on-site supervision work papers. Discuss with staff to identify gaps in the regulations and, their application, and the training needs of on-site supervision staff.
- (ii) Propose changes to improve the prudential regulations. The changes must be cognizant of the banking environment in Cambodia and the region in terms of the different types of businesses, products, and practices.
- (iii) Consult with relevant stakeholders and prepare on-site supervision risk-based procedures relevant to the banking environment in Cambodia and the region in terms of the different types of businesses, products and practices.
- (iv) Consult with relevant stakeholders to formulate an on-site work program that will enable the unit staff to undertake on-site inspections of all banks. Close attention is to be paid to banks that exhibit medium-to-high risks in their business operations.
- (v) Provide on-the-job guidance to staff on the application of the procedures to at least three banks (two of which are to be in the "high risk" category). Ensure that

¹ NBC proposed to use the budget allocation for the domestic consultant for public awareness workshops to disseminate the new law on negotiable instrument and payment transactions including its implementing regulations. The staff of the Banking Supervision Department will provide all the necessary support to the international expert. The mission supported the proposal, which is reflected in the table of cost estimates and financing plan.

staff have some training on planning the on-site visit; are able to document, analyze, evaluate, and report their findings; make recommendations for follow-up actions; and implement those actions.

- (vi) Assist the Supervision Department in defining the terms of reference of the financial intelligence unit, identifying staffing needs, and establishing the unit;
- (vii) Provide inception, interim, and final reports as required to NBC and ADB.

b. Negotiable Instruments and Payment System Legal Expert (2 person-months, intermittent)

9. The expert must have a legal background in payment and/or settlement systems with extensive working experience in developing materials for and conduct of workshops to explain the regime to several stakeholders with limited knowledge of the subject. Familiarity with the legal and regulatory framework for banking, finance, and commerce in Cambodia will be an advantage. The expert will help NBC during two field visits with public dissemination of the negotiable instrument and payment transactions regime. In addition, the expert will undertake the following tasks:

- (i) Provide support to NBC, if required, during the debates at the National Assembly of the current draft of the negotiable instruments and payment transactions law.
- (ii) Conduct awareness workshops and/or seminars to explain the new legislation and its implementing regulations. Cooperate with the training expert in the formulation of the commercial law courses.
- (iii) Provide training to staff of NBC banking and payment units on the new law and implementing regulations.
- (iv) Through the workshops in (ii), discuss and report on weaknesses in the existing payment and settlement system and/or procedures used by NBC and the banking subsector including proposed solutions.
- (v) Provide all the reports as required to NBC and ADB.

c. Insurance Supervision Expert (5 person-months, intermittent)

10. The international insurance expert must have extensive knowledge and hands-on experience in insurance supervision and regulations, especially in designing and enforcing prudential regulations. Familiarity with the legal and regulatory framework for insurance in Cambodia and the region will be an advantage. The expert will assist the Department of Financial Industry, MEF, during three field visits in enhancing the supervision capacity of its staff. In addition, the expert will undertake the following tasks:

- (i) Funds permitting, organize a study tour for senior staff of the insurance unit of the Department of Financial Industry to a neighboring country to observe and obtain first-hand experience on how the insurance regulator operates.
- (ii) In consultation with relevant stakeholders, formulate the organizational strategy (including an appropriate organizational structure) and business development

plan to strengthen the Department of Financial Industry's effectiveness as an insurance supervisor. Approval of the MEF minister must be obtained.

- (iii) Review the relevant prudential regulations for insurance and work papers, and discuss with staff to identify gaps in the regulations and their application, and the training needs of insurance supervision staff. Recommend improvements to propose new risk-based insurance prudential instructions.
- (iv) Based on the results from item (iii) prepare guidelines and/or procedures to help insurance supervision staff carry out both their off-site and on-site functions.
- (v) Based on the results of items (iii) and (iv), provide training and on-the-job guidance to help staff implement the insurance supervision guidelines and procedures including at least two on-site inspection reviews.
- (vi) Provide inception, interim, and final reports as required to MEF and ADB.

d. Insurance Corporate Restructuring Expert (2.5 person-months, intermittent)

11. The international insurance corporate restructuring expert must have extensive knowledge in insurance and hands-on experience in corporate restructuring. Familiarity with the legal and regulatory framework for insurance, as well as the labor retrenchment procedures in Cambodia will be an advantage. The international insurance corporate restructuring expert, over two field visits, will

- (i) provide guidance to the MEF, and the board of directors and chief executive officer of Caminco in implementing the approved restructuring plan for Caminco; and ensure that it meets the approved implementation schedule;
- (ii) suggest alternative solutions, in close consultation with ADB, to resolve any implementation issues; and
- (iii) provide all the reports as required to MEF and ADB.

e. Training Expert on Commercial Laws (2 person-months, intermittent)

12. The international training expert on commercial laws must have extensive knowledge of commercial laws and hands-on experience in developing appropriate training modules for a target group. Familiarity with the legal and regulatory framework of the financial sector in Cambodia will be an advantage. The expert, over two field visits, will assist MOC in developing commercial law courses for targeted legal training institutions. The courses will incorporate principles of law drawn from both existing laws and draft legislation currently being considered by the Government. In addition, the international training expert will undertake the following:

- (i) Assist MOC in liaising with the legal training institutions to include the new commercial law courses in their curricula. This may be in the form of short-term seminars for judges, lawyers, and legal clerks to create awareness and a demand for the commercial law modules.
- (ii) Provide reports as required to MOC and ADB.

2. Domestic Consultants

a. Insurance Supervision Expert (7 person-months, intermittent)

13. The expert will be required to have some working knowledge of insurance regulations, a good understanding of the insurance subsector, and be proficient in English. Prior working experience with international organizations will be an advantage. In addition, the expert will undertake the following tasks:

- (i) Assist the international insurance supervision expert in all aspects of his/her assigned terms of reference including the arrangements of meetings in-country.
- (ii) Under the guidance of the international expert, gather and analyze the required information and data, and ensure that reports are available in English.
- (iii) Act as translator/interpreter for the international expert and ADB missions, when required.
- (iv) Assist the international expert in preparing the required reports for MEF and ADB.

b. Insurance Expert (4 person months, intermittent)

14. The expert will be required to have some working knowledge of insurance operations, a good understanding of the insurance subsector, and be proficient in English. Prior working experience with international organizations will be an advantage. In addition, the expert will undertake the following tasks:

- (v) Assist the international insurance corporate restructuring expert in all aspects of his or her assigned terms of reference including the arrangements of meetings in- country.
- (vi) Under the guidance of the international expert, gather and analyze the required information and data, and ensure that reports are available in English.
- (vii) Act as translator and interpreter for the international expert and ADB missions, when required.
- (viii) Assist the international expert in preparing the required reports for MEF and ADB.

c. Legal Training Expert (3 person months, intermittent)

15. The expert will be required to have a background in law and commerce, a good understanding of the Cambodian financial sector, and be proficient in English. Prior working experience with international organizations will be an advantage. In addition, the expert will undertake the following tasks:

- (i) Assist the international training expert on commercial laws in all aspect of his or her assigned terms of reference including the arrangement of meetings and workshops seminars in-country.
- (ii) Under the guidance of the international expert, gather and analyze the required information and data, and ensure that a report on the information and data is available in English.
- (iii) Act as translator or interpreter for the international expert and ADB missions when required.

Achievements of Subprograms I and II and Proposed Actions for Subprogram III

Subprogram I	Status of Subprogram I	Subprogram II	Status of Subprogram II	Proposed Actions for Subprogram III
1. Banking Subsector		1. Banking Subsector		1. Development of the Banking Subsector
a. Strengthening Bank Supervision/Prudential Regulations		a. Developing Banking Subsector Infrastructure and Safety Net		a. Development of Banking Subsector Infrastructure
National Bank of Cambodia (NBC) to reconcile old prudential regulations with new regulations and issue clarifying guidance to commercial banks	Achieved	NBC to adopt a guideline for the arrangements for sharing credit information among the members of the bankers association; NBC and the bankers association are to establish such arrangements	Achieved	
NBC to fully staff the on-site inspection division of the Banking Supervision Department, acceptable to ADB	Achieved	NBC to adopt a uniform chart of bank accounts and disclosure rules for the commercial banks consistent with international accounting standards (IAS)	Achieved	
NBC to adopt a formal procedure for soliciting comments from the private sector on proposed or revisions to laws, regulations, procedures, and policies affecting the banking subsector	Achieved	NBC to apply the uniform chart of bank accounts and disclosure rules for the commercial banks, consistent with IAS, to the Rural Development Bank, and other specialized banks	Achieved	
NBC to adopt surveillance and inspection procedures including standardization of the reports submitted by commercial banks; unless specified otherwise in the NBC regulations, these procedures are also to be applied to licensed microfinance institutions (MFIs)	Achieved	MOC to submit to the National Assembly a draft secured transactions law	Achieved	Adoption of a secured transactions law by the National Assembly
		MOC to adopt a plan to establish a public registry for secured transactions acceptable to the Asian Development Bank (ADB)	Achieved	MOC to establish a public registry for secured transactions
NBC to adopt a prompt corrective action system for commercial banks, acceptable to ADB. A similar system is to be applied to licensed MFIs with modified	Achieved	b. Capacity Building		
		NBC to ensure that the CBS establishes a central banking course for NBC professional staff, including a mandatory training program for entry-	Achieved	NBC to form a unit and undertake the preparatory work needed to establish a financial intelligence unit

Subprogram I	Status of Subprogram I	Subprogram II	Status of Subprogram II	Proposed Actions for Subprogram III
<p>capital adequacy standards</p> <p>NBC to adopt an anti-money laundering regulation; unless specified otherwise in the NBC regulations, this regulation is also to be applied to licensed MFIs</p> <p>b. Capacity Building</p> <p>NBC to establish a center for banking studies (CBS) as a subsidiary of NBC with separate management and accounts</p> <p>NBC to ensure that Foreign Trade Bank management adopts a comprehensive staff training program, including accounting, risk management, asset and liability management, and a management information system</p>	<p>Achieved</p> <p>Achieved</p> <p>Achieved</p>	<p>level professional staff</p>		<p>responsible for anti-money laundering and combating the financing of terrorism</p> <p>b. Commercial Law Development and Capacity Building</p> <p>Adoption of a law for commercial arbitration by the National Assembly</p> <p>Submission of an insolvency law to the National Assembly</p> <p>MOC to ensure dissemination of commercial laws via the Internet</p> <p>MOC to work with the relevant law institutes to develop commercial law curricula based on the new commercial laws for training judges, lawyers, and legal clerical staff</p>
<p>2. Insurance Subsector</p> <p>a. Establishing Supervisory and/or Regulatory Framework for Insurance Development</p> <p>MEF to establish an insurance supervisory unit within MEF</p> <p>MEF to ensure issuance of a subdecree to implement the Insurance Law</p>	<p>Achieved</p> <p>Achieved</p>	<p>2. Insurance Subsector</p> <p>a. Establishing Framework for Compulsory Insurance</p> <p>MEF, in consultation with related ministries, to adopt interministerial regulations for the development of compulsory insurance</p> <p>b. Promoting Private Sector Development</p> <p>MEF to establish a joint venture between the</p>	<p>Achieved</p> <p>Partially achieved and</p>	<p>2. Development of the Insurance Subsector</p> <p>a. Strengthening Capacity of the Regulator</p> <p>MEF to review, update, and implement appropriate prudential regulations to enhance solvency, liquidity, and corporate governance requirements; and support technical assistance to the insurance regulator</p> <p>b. Promoting Private Sector</p>

Subprogram I	Status of Subprogram I	Subprogram II	Status of Subprogram II	Proposed Actions for Subprogram III
		state-owned insurance company and a private insurance company	moved to subprogram III	involvement in the Insurance subsector MEF to implement the key actions of the plan to restructure Caminco, as agreed with ADB with a view to divest the Government's shares at the earliest opportunity
3. Money/Interbank Markets a. Creating Interbank Market Arrangements NBC to recognize the bankers association as a self-regulatory organization: -Approved articles of association must include provisions for the establishment of interbank market arrangements, arrangements for sharing credit information among the members of the bankers association, and a banking institute for private bank staff. -NBC and the bankers association are to establish a working group to develop interbank market arrangements, arrangements for sharing credit information among the members of the bankers association, and a banking institute	Achieved	3. Money/Interbank Markets NBC to submit to the National Assembly a draft law on negotiable instruments and payment transactions	Achieved	3. Development of Interbank and Money Markets a. Legal Framework for Money Market Development The National Assembly adopts a law on negotiable instruments and payment transactions NBC to draft and adopt implementing regulations for the law on negotiable instruments and payment transactions

