

Chapter 6

Banking and Financial Sector Reforms

The reform of the banking and financial sector completed its phase one at the end of 2004 and kicked off phase two in 2005. Some progress has been made during 2001-2004, especially in laying out a regulatory and supervisory framework for the banking and financial sector. Thus, this part will examine progress, impacts and remaining issues after phase one implementation with restriction to three critical sectors: banking, rural finance and insurance.

6.1. Banking Sector

All banks have been well capitalized and the banking system has been subjected to a regulatory and supervisory regime. The National Bank of Cambodia regularly monitors commercial banks through both off-site surveillance and on-site inspection. As a result from this supervision, NBC found some major shortcomings such as a short fall in net worth, a deficiency in the capital guarantee deposits, a low insolvency ration, a high ratio of investment in fixed assets, and a high prepayment for rent and leases. Several more NBC *Prakas* were issued in 2004 to enhance commercial bank supervision.²⁴

Implementing the Banking and Financial Institution Laws and the Financial Sector Blueprint produced some positive impacts on the banking sector. The sector appears to have a stable system, and to be on track and healthy growth. By September 2005, the number of commercial banks increased up to 15 from 14 in 2002 including one state-owned bank. Some commercial banks have expanded their operations to some major provincial cities. Yet, their expansion is concentrated in only three major cities Siem Reap, Sihanouk Ville and Battambang where demand for banking services is growing.

Commercial banks' role as an agent for financial intermediation has improved and seemed to bring back public confidence from both individuals and corporations. Total deposit posted a 33 percent increase in 2004 (from CR 2,420 billion in 2003 to CR 3,209 billion in 2004) compared

²⁴ (1) *Prakas* on payments of dividends in advance; (2) *Prakas* on prepaid prepayments on rental and leases; (3) *Prakas* on requirement in compliance with fact and substance; (4) *Prakas* on amendments relating to liquidity; (5) *Prakas* relating to the banks' solvency ratio; (6) *Prakas* on the annual audit of financial statements of banks and financial institutions; (7) *Prakas* on license fees for banks and financial institutions; (8) Circular on installment loan classification and provisioning; (9) Circular on non-performing loans, provisions and interests accounting.

with a 22 percent increase in 2001 (from CR 1,335 billion in 2000 to CR 1,626 billion in 2001, a period before commencing blueprint implementation).²⁵ Similarly, during the same comparison period total credit provided by banks rose 36 percent (from CR 1,369 billion in 2003 to CR 1,869 billion in 2004) compared with an 8 percent rose (from about CR 908 million in 2000 to CR985 million in 2001).

Table 6.1: Commercial Bank Expansion

Banks	Branches in the Provinces
Commercial Bank	
Advanced Bank of Asia	Not yet
ACLEDA Bank Ltd	All 22 provinces and towns with 136 branches
ANZ Royal Bank Cambodia Ltd.	Not yet
Cambodia Asia Bank	Not yet
Canadia Bank Ltd.	Sihanouk Ville, Battambang, Kampong Cham, Pailin, Siem Reap, Poipet and Kampot
Cambodian Commercial Bank	Battambang and Siem Reap
Cambodian Mekong Bank	Siem Reap and Sihanouk Ville
Cambodian Public Bank	Siem Reap
Singapore Banking Corporation	Not yet
Union Commercial Bank	Sihanouk Ville, Siem Reap & Battambang
Vattanac Bank	Siem Reap
First Commercial Bank	Not yet
Krung Thai Bank	Siem Reap
May Bank	Not yet
Foreign Trade Bank	Not yet
Specialized Banks	
Rural Development Bank	Not yet
Peng Heng S.M.E Ltd	Not yet
Cambodia Agriculture Industrial specialized bank	Not yet
Representative Office	
Standard Chartered	

Source: NBC Quarterly Review 13.

²⁵ According to National Bank of Cambodia's Annual Report, Appendix 7, Table 7.

Despite these achievements, commercial banks still play limited roles in facilitating investment, particularly in providing loans. According to a survey by EIC as a partner of World Economic Forum in February-March 2005 with 100 top businesses executive 80 percent of respondents said it was difficult to access loans from commercial banks if they do not have collaterals (Chan & Sok, 2005). The insufficient lending to business is due to such major reasons as (i) weak credit risk assessment capacity of these commercial banks; (ii) unavailability and in some cases unreliability of borrower information; (iii) absence of financial contract enforceability.

Table 6.2: Recent Developments in Banking Sector

Progress	Remained Issues
▪ Completed bank re-licensing program. Capitalized banking system ▪ Established regulatory and supervisory regime. In 2004, 13 banks out of 14 banks implemented COAs. Starting from 2005, required banks to issue annual reports audited by external auditing firms ▪ Issued more <i>Prakas</i> and <i>Circular</i> ▪ Implemented full on-site supervision in 2004 with well trained staff using CAMELS methodology ▪ Carried out off-site surveillance by examining financial reports and annual auditing report on commercial banks compliance with NBC's legislation, regulations and instructions ▪ Improved financial intermediary services ▪ Obtained increasing public confidence in banking services	▪ Having limited roles in facilitating private investment and in providing loans to rural areas ▪ Lacking credit assessment capacity of commercial banks ▪ Delaying enactment of negotiable instruments and payment transactions, company law, bankruptcy law, secured transactions law and law on money laundering and combat terrorism financing, and securities and exchange law ▪ Implementing full adoption of COAs ▪ Delaying FTB privatization ▪ Further encouraging public confidence in banking system and services ▪ Further encouraging financial intermediary services

Source: *Cambodia Economic Watch (2005) and NBC Annual Report 2004.*

Although commercial banks started to expand their branches to some major provinces, they appeared to engage little in providing small loans to the rural economy. Among 15 commercial banks, only Canadia and ACLEDA (which used to operate as an MFI before December 2003) operate rural finance activities.

Furthermore, a sound and strong foundation of the banking system has not yet been established as major pieces of legislation remained in draft

forms: Bankruptcy law, secured transaction law and the law on anti-money laundering and combating terrorism financing.

6.2. Rural Finance

Rural finance is also observed to have progressed after implementing the law on banking and financial institutions and the blueprint. The government has made efforts to establish regulations and instructions for rural finance operators. For instance, MFIs and registered NGOs are subject to both off-site surveillance and on-site inspections as they need to submit various financial reports regularly to the National Bank of Cambodia (NBC).²⁶ As a result, rural finance sector reform impacts significantly in integrating MFIs and NGOs into a formal financial system. Just less than a year from September 2004 to June 2005, two MFIs – Prasac Micro Finance Institution and the Farmer Union Development Fund – obtained licenses from NBC; Volunteer Career Development Community registered with NBC.

Table 6.3: Recent Developments in Rural Finance Sector

Progress	Remained Issues
- Established regulatory and supervisory regime. Issued several <i>Prakas</i> and instructions - Commercialized and transformed MFIs to formal financial system by encouraging rural credit operators to obtain license and to register with NBC - As of 30 June 2005 number of licensed MFIs is 11, up from 9 as of 30 September 2004 - As of 30 June 2005, number of registered NGOs is 31, up from 30 as of 30 September 2004 - Carried out off-site surveillance and on-site inspection on licensed MFIs and registered NGOs	- Registration of all rural credit operators is not yet completed - Improving regulation and supervision capacity of NBC - Regulations to protect depositors have not yet developed. - Limitation of household access to rural credits, especially remote area. Insufficient deposits in rural credit operators. As of June 2006, total loans was US\$77 million to about 392,892 borrowers; total deposits was US\$23 million from about 155,137 - Encouraging commercial banks to engage in rural credit operations

Sources: *Cambodia Economic Watch (2005), NBC Annual Report (2004), NBC Quarterly Review 11, 12 & 13 and CGAP (2005).*

Nonetheless, access to credits especially households in remote areas is still limited. As of June 2004, the CGAP report stated that MFIs and

²⁶ For further details of types of reports, please see Cambodian Economic Watch, April 2005, footnote 42, page 47.

registered NGOs had provided loans amounting to US\$77 million to 393,000 borrowers. This provision is far lower than the demand of US\$120 million- US\$130 million which was estimated by NBC in 2002 (UNDP, 2004). Deposits are also at a low level as total savings in MFIs and registered NGOs collected around US\$23 million of which former rural finance operator, ACLEDA bank, accounted for nearly 95 percent. Furthermore, supervision of rural credit operators is insufficient due to NBC's staff being relatively short of capacity and resources to manage growing microfinance activities.

6.3. Insurance Sector

Progress has been made in the insurance sector. An inter-ministerial *Prakas* - Ministry of Interior, Ministry of Tourism, Ministry of Public Works and Transport and Ministry of Economy and Finance - was issued in 2002 on three areas of compulsory insurances: (i) compulsory motor vehicles or third party liability insurance; (ii) compulsory insurance of passenger transports; and (iii) compulsory insurance for construction site.²⁷

Table 6.4: Recent Developments in Insurance Sector

Progress	Remained Issues
▪ Promulgated Law on Insurance ▪ Established compulsory insurance ▪ Four operators: (1) Asia Insurance Ltd.; (2) Forte Insurance (Cambodia) Plc; (3) CAMINCO; (4) International Commercial Insurance Company Plc	▪ Insufficient enforcement of compulsory insurance due to lack of enforcement and monitoring mechanism ▪ Weak supervisory and regulatory capacity ▪ Lack of public awareness of insurance services

Source: Cambodia Economic Watch (2005), ADB (2002) and MEF, Insurance Division (2005).

This legal framework brings positive effects for the insurance business. As of September 2005, there are companies operating insurance businesses with sector leader Asia Insurance (46%), runner-up Forte Insurance (43%), CAMINCO (11%) and a new entrant, International Commercial Insurance Company. This compulsory insurance also opens

²⁷ Compulsory Motor Vehicle or Third Party Liability Insurance: all types of commercial motor vehicles caring goods, passengers, and tourists; all types of motor vehicles owned by a company, enterprise or factory; motor vehicles of non-governmental organizations, international organizations and associations; motor propelled or towed cement mixers and construction vehicles; and motor tricycle used for the transport of goods or passengers. Compulsory Insurance of Passenger Transports: all types of passenger transport are required to have passenger transport liability insurance. Compulsory Insurance for Construction Site: all constructions, rehabilitation of existing constructions, and installations that are under the responsibilities of entrepreneurs, contactors or sub-contractors shall purchase construction liability insurance

markets for insurers. Automobile insurance gained US\$1.6 million which took the market share of 17 percent of business underwritten in 2004. Third party liability insurance boosted the miscellaneous class to account for 38 percent of Cambodian insurance markets.

**Table 6.5: Cambodia: Gross Premium Written
by Line of Business, 2004**

Line of Business	Gross Premium (US\$)	Share
Auto	1,526,621	17%
Fire	2,412,011	27%
Marine	325,685	4%
Engineering	180,222	2%
Workman Compensation (WC)	53,015	1%
Personal Accident (PA)	511,577	6%
Health and Surgical (H&S)	427,008	5%
Miscellaneous	3,437,722	39%
Total	8,873,870	100%

Source: *Asia Insurance Review* (2005).

Despite these improvements in regulatory frameworks, enforcement of the inter-ministerial *Prakas* of compulsory insurance is not so strong due to insufficient enforcement and monitoring mechanisms and resources. The insurance division of MEF is young; the understanding of the insurance business of relevant ministries is lacking; and government law enforcement efforts have been undermined by insufficient financial resources and incentives.