

Chapter 6

Banking and Financial Sector Reforms

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“What the NBC and other responsible ministries have achieved up to now with respect to the implementation of the strategic Blueprint has been assessed of being met their expectations to a large extent. Although much progress has been achieved there is no cause for complacency. We understand that implementing the Blueprint is a lengthy process, and that we are only the very beginning of it. Two main factors to ensure successful implementation are valued to underline: human resource capacity and outside support.” (NBC, 2004a, p.17)

“In the financial area, reforms were successful in setting up the basis for a two-tier banking system, strengthening the soundness of the banking sector and subjecting banks to a comprehensive regulatory and supervisory regime. Key bank soundness indicators improved visibly. However, financial intermediation remained very limited by international standards, particularly in rural areas, where the absence of credit has been considered a key constraint in raising farm output and incomes.” (IMF, 2004a, p.11)

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Although the reforms on the banking and financial sector started in 1989, it took 12 years for Cambodia to have a comprehensive plan for developing this sector. The government of Cambodia adopted a long-term vision and development strategy called the “Financial Sector Blueprint for 2001-2010” with technical assistance from the Asian Development Bank (ADB).³⁴

This blueprint lays out a coherent and systematic development plan for the banking and financial sector, namely banking, rural finance, insurance and pensions, non-bank financial institutions, money markets, capital markets and the financial market infrastructure as a whole. The blueprint set out the reforms in three phases, with phase one from 2001-2004, phase two from 2005-2007 and phase three from 2008-2010. Hence, it is crucial to review the actual actions made by the government during the phase one.³⁵

³⁴ The blueprint was approved by the government on 24 August, 2004.

³⁵ Reforms on non-bank financial institutions will be started in 2005, according to the blueprint.

6.1. The Banking Sector

Progress in banking sector reform was relatively modest (See Box 6.1 for recent developments). Progress has been made in developing a regulatory framework for prudential regulations and banking supervision. The National Bank of Cambodia (NBC) issued several *prakas* (ministerial-level regulations) on prudent guidelines on risk management and capital adequacy requirement.³⁶ For example, in 2002, the NBC issued *prakas* on standardized supervision procedures, on procedures for prompt corrective actions and on standardised procedures for identification of money laundering. Besides this, the international accounting standard Chart of Accounts (COAs) was introduced to all commercial banks in 2002 and was expected to be fully implemented by the end of 2004. CAMELS rating, the universal practice used to evaluate bank performances, was introduced in 2003.³⁷ For instance, the NBC's banking supervision department only conducted on-site inspections for three commercial banks in 2002, six in 2003, and 14 commercial banks and three specialized banks in 2004.

Box 6.1: Recent Developments in Banking Sector Reform

Progress	Remained Issues
- Developed framework for supervision, in particular prudent regulations. Several <i>prakas</i> have been issued. - Implemented Chart of Accounts (COAs) for banking and financial institutions. Yet, fully implementation was delayed. - Successfully completed commercial banks re-licensing program - Improved clearing systems for US dollar and CR - Established "Association of Banks in Cambodia"	- Reserve requirement of 8% was not streamlined. - Guarantee deposit of 10% was not phased out. - Ensure full adoption of COAs for all banking and financial institutions. - Law on money laundering is still in draft form. - Privatisation of FTB is delayed. - Law on Negotiable Instruments and Payment Transactions is at NA. - Comprehensive retraining program for non-college level NBC staff has not yet been developed. - A professional institute for bankers was not established.

Source: Selected from matrix A2.1 in the Appendix 2.

³⁶ *Prakas* are regulations. In Cambodia, ministers (and the governor of the central bank) are entitled to issue *prakas*.

³⁷ CAMELS is an acronym for six components of sound and safe banks: Capital protection (C), Asset quality (A), Management competence (M), Earnings strength (E), Liquidity risk exposure (L), and Sensitivity to market risk (S).

Table 6.1: The banking system before and after the relicensing programme

Before relicensing program	After relicensing program
1. Foreign Trade Bank (state-owned bank) 2. First Commercial Bank 3. Krung Thai Bank 4. Maybank 5. Cambodia Asia Bank 6. Canadia Bank Ltd. 7. Cambodian Commercial Bank 8. Cambodia Mekong Bank 9. Cambodia Public Bank 10. Singapore Banking Corporation 11. Union Commercial Bank 12. Vattanac Bank 13. Rural Development Bank (state-owned bank) 14. Cambodia Agriculture, Industry and Commerce Bank 15. Standard Chartered 16. Bangkok Bank 17. Thai Farmers Bank 18. Credit Agricole Indosuez Bank 19. Cambodia Agriculture-Commercial Bank 20. Phnom Penh City Bank 21. Chansavangwonk Bank Corporation 22. Singapore Commercial Bank 23. Rich Nation Bank 24. Global Commercial Bank 25. Peace Commercial Bank 26. First Overseas Bank 27. Great International Bank Ltd. 28. Emperor International Bank 29. Cambodia Bank International 30. Angkor Bank 31. Cambodia Farmers Bank	1. Foreign Trade Bank (state-owned commercial bank) 2. First Commercial Bank 3. Krung Thai Bank 4. Maybank 5. Advanced Bank of Asia 6. Cambodia Asia Bank 7. Canadia Bank Ltd. 8. Cambodian Commercial Bank 9. Cambodia Mekong Bank 10. Cambodian Public Bank 11. Singapore Banking Corporation 12. Union Commercial Bank 13. Vattanac Bank 14. ACLEDA Bank Limited 15. Rural Development Bank (state-owned specialized bank) 16. Peng Heng S.M.E. Limited 17. Cambodia Agriculture Industrial Specialized Bank 18. Standard Chartered (representative office)

Sources: UNDP (2004), National Bank of Cambodia (2004d) and (2000).

Likewise, the commercial bank re-licensing programme to liquidate insolvent banks, which was started after the promulgation of the 1999 law on banking and financial institutions, was successfully completed in 2003. This programme required all commercial banks to have a capital requirement of

CR50 billion (approximately US\$13 million).³⁸ Consequently, the re-licensing implementation reduced the number of banks from 31 before 2000 to only 18 in 2004 (Table 6.1).³⁹ Those 13 banks no longer in existence were closed by either voluntary or compulsory liquidation. However, one new bank, ANZ Royal Bank Cambodia, will soon emerge. It is a joint venture between the Melbourne-based Australia New Zealand Banking Group (ANZ), one of the world largest banks, and the Royal Group of Cambodia, one of the leading local companies.⁴⁰

There was progress on the restructuring of the state-owned commercial Foreign Trade Bank of Cambodia (FTB), but it was slower than expected. The FTB was separated from the NBC in 2001, and the Ministry of Economy and Finance holds a majority share of 80 percent (the NBC holds the remaining 20 percent). The intention to privatise the FTB by 2004 was unsuccessful.

Similarly to banking supervision and restructuring, some efforts were also made to establish a framework for the payment system. A clearing house for US dollar denominated checks was created in late 2000 in addition to the existing clearing house for Cambodian riel. A law on negotiable instruments and payment transactions, which aims to improve payment transactions, eliminate legal uncertainties and reduce payment system risks, is currently awaiting approval by the National Assembly.

Despite some progress mentioned above, little effort has been made to establish a basic framework for monetary policy and building capacity mechanisms for the whole industry. The reserve requirement on deposits in both foreign and local currency is still 8 percent, as it was first set in 1993. As a result, this idle reserve is enormous and increases commercial banks' operating costs. In addition, the guarantee deposit of 10 percent of total capital has not been phased out yet; rediscount and refinance facilities have not been implemented.

Just like monetary policy framework, few actions were taken on building capacity for the NBC and the whole industry. A comprehensive retraining program for non-college level NBC staff has not yet been

³⁸ The exchange rate was 1US\$=3900 riel. However, with the current exchange rate of 1US\$=4000 riel, the capital requirement is US\$12.5 million.

³⁹ 31 banks: 22 private commercial banks, 7 foreign bank branches, and 2 state-owned banks.

⁴⁰ According to the Phnom Penh Post's special supplement for Australia Day, the ANZ Royal Cambodia is on track to open in 2005. ANZ is a major international banking and financial services group with total assets of over US\$180 billion. It is also the leading bank in Asia, operating a network of 14 offices in China, Hong Kong, Indonesia, Japan, South Korea, Malaysia, the Philippines, Singapore, Taiwan, Thailand and Vietnam.

developed, although some staff members have been sent to receive training at the Centre for Banking Studies. A banking institute for the professional training of commercial bankers has not been established even though the association of bankers was created four years ago.

6.2. Rural Finance

The government has succeeded, to a certain extent, in putting rural credit-operating NGOs and Micro-Finance Institutions (MFI) under regulations and in laying out a supervisory regime. By the end of September 2004, 30 NGOs had been registered with the NBC; in addition, licensed MFIs increased from five in 2003 to nine in 2004.⁴¹

Despite this number of registered and unregistered credit providers, the supply of credit does not match demand due to their very limited capacity. According to a UNDP report in 2004, only 420,000 households, or 15 percent, are estimated to have accessed this credit.

Box 6.2: Recent Developments in Rural Finance Sector Reform

Progress	Remained Issues
- Implemented Law on Banking and Financial Institutions to MFIs. For example, licensing requirement, reserve requirement of 5%. - Strengthen MFIs supervision: on-site inspection and off-site surveillance, COAs implementation, and prudential regulation for registered MFIs. - Facilitate in issuing license to MFI and in registering NGOs rural credit operators	- Full inspection on all licensed MFIs and registered NGOs was not done. - Full registration of rural credit operators was not yet in place. - Access to rural credits provided by MFIs and NGOs and deposits at these institutions remained very limited. - Deposits at licensed MFIs are at low level.

Source: Selected from matrix A2.2 in Appendix 2.

In the area of supervision, the NBC issued many regulations for banks including the requirement for them to have reserves of 5 percent of total holdings, be subject to on-site inspection and off-site surveillance, implement COAs and submit reports monthly, quarterly and annually.⁴² As

⁴¹ As of September 2004, licensed MFIs are Ennatiem Moulethan Tchonnebat (EMT), Hatthakaksekar, Tong Fang Microfinance Limited, Thaneakea Phum Cambodia, Cambodian Entrepreneur Building Ltd., Seilanithih Limited, Angkor Microheranhvatho Kampuchea, Vision Fund (Cambodia) Ltd. and Credit. Moreover, the NBC estimates that there are nearly 60 unregistered NGOs operating in rural credit activities.

⁴² Monthly reports include statements of assets and liabilities, statements of profits and loss, off-balance sheet, breakdown of deposits by category, breakdown of deposits by currency, loan breakdown by category, loan breakdown by currency, loan classification, loan loss provisions and

a result of *prakas* on on-site inspection implementation, the NBC's supervision department conducted inspections of nine licensed MFIs and 27 registered NGOs in both 2003 and 2004 (NBC, 2004c). Many NGOs, however, have not been supervised by the NBC due to their locations and their very limited activities. As the UNDP (2004, p. 185) has stated "many of these are indigenous NGOs that are located in areas difficult to reach and their activities may be too small to warrant the cost of supervision."

Therefore, strengthening supervisory bodies, encouraging the involvement of commercial banks in rural credit, and improving the existing operations of MFIs and NGOs will ensure the outreach of sustainable rural finance for reducing poverty.

6.3. Insurance Sector and Pension System

The government made some progress in the insurance sector (See Box 6.3 for recent developments). The insurance division was established under the Financial Industry Department of the MEF in 2001. This division started implementing the insurance law, which requires a minimum capital of 5,000,000 SDR for life insurance companies and general insurance companies, and 10,000,000 SDR for any companies to operate in both fields.⁴³ As a consequence of the insurance law and the blueprint implementation, a French-owned leading insurer in Cambodia, Indochine Insurance, was closed in October 2004 after the company failed to meet the government's legal requirement of US\$7 million capital investment.

Another achievement of the blueprint action plan is the successful establishment of a framework for compulsory insurance. The inter-ministerial working group was created and this team issued a *Prakas* on compulsory insurance such as (i) compulsory insurance on motor vehicles; (ii) third party liability insurance; (iii) compulsory passenger transport liability; and (iv) compulsory insurance for a contractor's general liability. Yet full compliance of compulsory insurance has not been enforced.

delinquency ratio, list of loans to related parties, list of large exposures, calculation of capital adequacy ratio, calculation of liquidity ratio; quarterly reports include statement of assets and liabilities, statements of profits and loss, breakdown of deposits by category and currency, loan breakdown by category and currency, loan classification and delinquency ratio, network of branches and other offices; annual reports include audited financial statements, board of directors' annual report, statistics of staff and salaries and updated organisation chart with names and titles of incumbents.

⁴³ SDR stands for Special Drawing Right. In October 2004, SDR 1= US\$1.4 which makes the capital requirement amount to US\$7 million. However, the value of US\$ in terms of SDR is changing daily; it is posted on the IMF website. For instance, on 08 August 2005, SDR1= US\$1.51644. Further explanation on SDR can be found at <http://www.imf.org/external/np/exr/facts/sdr.HTM>.

The last achievement of the government in carrying out the blueprint is the establishment of a basis for private sector development in the insurance sector. The function of reinsurance of state-owned company CAMINCO was removed, and this function has now been given to the insurance company Cambodia Re. This new state-owned company launched a joint venture with Asian Insurance International in October 2002.

Box 6.3: Recent Developments in the Insurance Sector and Pension System Reforms

Progress	Remained Issues
▪ Established insurance division ▪ Implemented insurance law. One leading insurer – Indochine – was closed ▪ Established inter-ministerial for compulsory insurance enforcement ▪ Introduced compulsory insurance: (i) motor vehicle; (ii) third part liability insurance; (iii) passenger transport liability; and (iv) contractor's general liability ▪ Lifted a reinsurance function of CAMINCO by establishing Cambodia Re. Cambodia Re joint venture with Asian Insurance International	▪ Compulsory insurance enforcement in these four areas is still very weak. ▪ Although some basic framework for this sector has been developed, more encouragement to use insurance needs to be done. ▪ A feasibility study on a public pension program, mandatory privately managed funded pension programs, and voluntary retirement savings programs have not been done yet.

Source: Selected from matrix A2. 3 in Appendix 2.

Nonetheless, the insurance sector remained underdeveloped. This is due to lack of complementary enforcement in other related areas. For instance, it is very risky for insurance companies to expand insurance policy coverage in the transportation sector as the number of traffic accidents resulting from bad driving habits increased. Underdevelopment of the insurance sector is also due to low demand. Currently, only large private companies and NGOs have bought insurance policies while individuals have ignored the need of holding insurances.

Contrary to the progress made in the insurance sector, the government has not taken any action on pension reform even though the blueprint required only a feasibility study to establish a multi-pillar pension system.

6.4. Money Markets, Capital Markets and Financial Market Infrastructure

The government's reforms on money markets and capital markets have not been satisfactorily achieved (See Box 6.4 for recent developments). Regulatory frameworks, procedures and master plans have progressed extremely slowly. Laws on negotiable instruments and payment transactions have not been approved by the National Assembly. Security Law and Law on Issuance and Trading of Non-Government Securities are still at COM.

Box 6.4: Recent Developments in Interbank/ Money Markets, Capital Markets and Financial Market Infrastructure Reforms

Progress	Remained Issues
Interbank/Money Markets Established a working group on interbank/money market	Interbank/Money Markets - Interbank market arrangement was not established. - Law on Negotiable Instruments and Payment Transactions has not been enacted by the NA.
Capital Markets Drafted Security Law and Law on Issuance and Trading of Non-government Securities and subdecree to implement these laws	Capital Markets - Enactment Securities and Exchange Law - Further strengthening Capital Market Development Unit
Financial Market Infrastructure - Drafted Law on Commercial Enterprise, Law on Bankruptcy, and Law on Secure Transactions - Adopted Law on corporate accounts - Established an accounting standard board, Kampuchea Institute of Certified Public Accountants and Auditors - Adopted Subdecree on the creation	Financial Market Infrastructure - These laws need approval from NA. - A civil code is still in draft form. - Slow progress in implementing Governance Action Plan - Commercial Court has not been established yet.

Source: Selected from matrix A2.4, A2.5, and A2.6 in Appendix 2.

Indeed, developing financial market infrastructure relies on needed law adoption and law enforcement together with other structural reforms, in particular governance reforms. It is noted that several pieces of legislation such as bankruptcy law, secured transaction law and a civil code

are still in draft forms. Thus, sound financial market infrastructure in Cambodia has not yet been fully developed but has been progressing.

In conclusion, progress in implementing phase one of the blueprint phase one has been mixed. Achievements can be only seen in establishing a regulatory and supervisory regime for banking, the rural finance sector and the insurance sector. The pension area has not been touched. The basic framework for money markets and capital markets has not been attained. Therefore, the government needs to make an effort to complete the remaining reform agendas in phase one (as shown in Box 6.1, 6.2, 6.3, and 6.4), as well as to start carrying out phase two. If the banking and financial sector reform programs envisaged in the blueprint are fully implemented, a sound and healthy banking and financial sector will be developed.