CAMBODIA

FINANCIAL SECTOR BLUEPRINT FOR 2001-2010

ASIAN DEVELOPMENT BANK

KINGDOM OF CAMBODIA

NATION RELIGION KING

FINANCIAL SECTOR BLUEPRINT FOR 2001-2010

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ASIAN DEVELOPMENT BANK

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CURRENCY EQUIVALENTS
(as of 14 November 2001)

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

ABBREVIATIONS

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

NOTE

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

FORWARD

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

Progress was also made in implementing structural reforms: a two-tier banking system is being put in place and new large denominated banknotes were introduced to promote "de-dollarization"; most non-tariff barriers were eliminated; the tariff structure was streamlined; a liberal foreign investment law was adopted; and the spread between the official and parallel market exchange rates has been substantially reduced. Since then, Cambodia has made impressive strides in re-establishing political and economic stability and re-integrating itself into the international community. However, the Government is conscious that an economy will not base and to comply with relevant laws and regulations. As a result, in November 2000, nineteen banks were allowed to continue operations, while twelve others were de-licensed and put under liquidation procedure. With these actions, the Government has in mind to bring up all existing banks to a higher standard, improving the soundness and reliability of the banking system, which is crucial for confidence building.

While much progress has been made in recent years in financial sector reform, still

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

(i) a competitive, integrated, and efficient banking system that is properly regulated and supervised and effectivel

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

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

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

PREFACE

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

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

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

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

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

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

(x) developing human and institutional capacity in both the private and public sectors through public-private sector partnerships.

Sector Development Plan

Under the guidance of the long-term strategy, the Blueprint details sector development strategy and policy reform agenda. The sector development plan explicitly considers the interrelationship of (i) human and institutional capacity building, (ii) developments in related financial infrastructure, (iii) establishment of a legal and regulatory framework, (iv) emergence of relevant financial markets, and (v) availability of technology. The sector development strategy is

Nonbank Financial Institutions

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

Interbank/Money Markets

The sequencing and pacing of money market development will match the development of the banking and nonbanking sectors. The development plan for interbank/money markets targets three strategic goals. The first phase aims to establish the foundation for a market in short-term unsecured interbank lending, and to provide a base for money markets (including Treasury Bills), based on a Negotiable Instruments Law. The second phase will strengthen the interbank markets by establishing regulations for diverse money market instruments such as negotiable certificates of deposit and repurchase agreements, as well as by regularizing the issuance of Treasury Bills with the development of a primary dealer system. The third phase is to broaden money markets with a regulatory framework for nonfinancial issuers of money market instruments such as commercial paper.

Capital Markets

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

and promote competition in the accounting industry to reduce the accounting and auditing compliance costs of the private sector. In Phase III, enforcement of accounting standards and expansion of International Accounting Standards to more firms will occur.

Financial Information Infrastructure. Development of a financial information system is

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I. INTRODUCTION

1. After longstanding domestic turmoil and subsequent international isolation in the 1980s, Cambodia began to return to a period of peace in 1993. Since then, the country has made steady efforts to recover in all aspects of socioeconomic development and to maintain social, political, and macroeconomic stability; and international aid operations have resumed.

2. The Socioeconomic Development Plan for 1996-2000 (SEDP I) marked the Government's first systematic efforts toward economic development to achieve economic growth, poverty reduction, and broad participation in the development process. Since the successful implementation of SEDP I, the Government has been engaged in finalizing the Socioeconomic Development Plan for 2001-2005 (SEDP II), which identifies poverty reduction as the primary development goal. SEDP II targets reducing the poverty rate from 36 percent

system is the key to ensuring macroeconomic stability, mobilizing savings, allocating resources for productive purposes, promoting private sector development, and in turn generating employment opportunities and reducing poverty. In a developing country like Cambodia, financial sector development will also contribute to promoting foreign direct investment (FDI) and safeguarding the economy from external shocks.

5. **Sustainable Economic Growth and Poverty Reduction.** The Royal Government of Cambodia (the Government) has identified poverty reduction as its priority. In its Interim Poverty Reduction Strategy paper, the Government outlined a broader approach based on a multidimensional assessment of poverty. Furthermore, it emphasized macroeconomic stability to foster sustainable growth that will create employment and have a long-term impact on reducing poverty.

6. Deficiencies in Cambodia's financial system undermine macroeconomic prospects and economic growth. The development of a sound, efficient, and well-regulated market-based financial system is crucial to achieving higher and sustainable economic growth and achieving the country's social and economic development objectives – poverty reduction, in particular.

7. **Enabling Macroeconomic Policy.** An important component for achieving and sustaining macroeconomic stability is a sound monetary policy to support growth, control

financial sector. It proposes reform agenda and illustrative policy actions over the three-phase, 10-year period.

12. The Blueprint is a multi-purpose plan for developing the financial sector and intends to serve as:

(i) the Government's planning tool for financial sector development,

(ii) the basis for formulating ADB's Financial Sector Program Loan, and

(iii) the coordination panel for external assistance to the financial sector.

13. Aid coordination is a key component underpinning the Blueprint strategy. Given the extent of issues that need to be addressed in financial sector development, such coordination will be critical to the effective allocation of resources. Funding agencies will be able to use the

Government adopted the Law on Banking and Financial Institutions (the Banking Law) in 1999 and a new Insurance Law in 2000. The Banking Law introduced more appropriate definitions for banking activities and a refined legal framework for banks. It also allowed microfinance institutions (MFIs) to undertake financial operations under the supervision of NBC. Furthermore,

22. As of December 2000, the total assets of the banking system stood at KR2,517 billion – the equivalent of $644 million, or 20 percent of GDP. This represented an increase of 20 percent since the end of 1999. During the same period, loans increased 31 percent to an equivalent of $249 million, while deposits increased 40 percent to an equivalent of $382 million. Loan growth occurred predominantly in the manufacturing and service sectors.

Table 1: Loans and Deposits in the Banking Sector as of December 2000

Item	Amount/Equivalent KR million	Amount/Equivalent $ million	As Percentage of GDP
Loans	972,747	249	7.60%
Deposits in KR	103,969	27	0.8%
Deposits in Foreign Currency	1,386,985	355	10.9%
Total Deposits	1,490,954	382	11.7%

Source: National Bank of Cambodia.

Figure 1. Bank Loan by Sector (KR Billion)

25. The high risk and operating costs associated with bank lending are reflected in a high interest rate spread and the prevalence of short-term lending. The spread between loan and deposit interest rates is estimated at around 13 percentage points, as loan interest rates are around 20 percent per annum or more. Typical loan maturity is 3-6 months, because banks are reluctant to provide loans with longer terms. Term finance is unavailable, and the usual practice is to continue rolling over short-term loans. This practice generates maturity mismatches and

liquidation have hampered and delayed early and orderly liquidation of delicensed banks. Bank regulations and the capacity of the Bank Supervision Department of NBC both need strengthening. In addition, lack of a uniform chart of bank accounts and disclosure rules hampers effective bank supervision and prudential regulations. Like their borrowers, commercial

D. The Insurance Sector

1. Background

40. The insurance sector consists of a Government-owned insurance entity, CAMINCO, which acted as both regulator and underwriter, and four private insurance companies that are

47. Third, the framework for private sector development in the insurance sector needs to be strengthened. The introduction of compulsory insurance would create a policy-driven demand

attractive alternative product for banks in an environment with inefficient infrastructure for will formalize current regulations.[8] The present situation creates payment uncertainties at the bank level, particularly in terms of determining the legality of checking deposit signatures, endorsements, and assignments. Moreover, promulgation of a negotiable instruments law should receive priority that goes beyond checks and covers bills of exchange, promissory notes, and other money market-type instruments.

H. Interbank/Money Markets

1. Background

64. There is no recognized interbank/money market operating in Cambodia other than an occasional exchange of deposits among a few banks that trust one another. The lack of an

74. Although adoption of a legal framework is a key step toward development of the private sector and the financial sector, there must be concerted efforts to prioritize adoption of the necessary laws, and by doing so, the Government can expedite the legislation process. With regard to the financial sector development, laws pertaining to commercial transactions, including accounting, negotiable instruments, secured transactions, commercial enterprises, bankruptcy, and contracts, must be given the first priority. The Accounting and Auditing Law and the Law on Commercial Enterprises must be promulgated to enable capital market development. Afterwards, the Government may proceed to adopt a securities and exchange law (or redraft the Capital Market Law).[9] In line with the adoption of the Law on Commercial Enterprises, the Bankruptcy Law must be adopted, to bolster the liquidation of delicensed banks on 8 December 2000. And in line with the adoption of the civil code and procedures, a secured transactions law and negotiable instruments law must be established to underpin commercial activities and financial transactions.

75. The establishment of a law enforcement mechanism also needs to be addressed in a systematic way. Most important, the Government should move forward with the judicial reform addressed in the Governance Action Plan. With regard to financial sector development, the Government also should draft a plan to establish a public registration system for secured transactions and make efforts to maintain the public confidence in such an enforcement mechanism.

K. Accounting and Auditing System

1. Background

76. Cambodia has yet to adopt common accounting and auditing standards and to establish

79. NBC has a broad legal mandate to regulate nearly all issues related to the accounting and auditing of banks. This goes beyond the usual prudential regulations to include establishment of the rules for measurement, recognition, and disclosure in the financial statements, and consolidation of accounts. The Central Banking Law also permits NBC to establish accounting standards for the banking sector that are separate from the tax regulations. NBC has drafted a uniform chart of accounts for banks. Most of the accounting policies are taken verbatim from the "Framework for the Preparation and Development of Financial Statements," published in July 1989. However, there are some substantive changes, so the

commercial banks, the Bankers Association, the Centre for Banking Studies (CBS) of NBC, and MEF.

84. Each commercial bank operating in Cambodia assumes individual responsibility for its internal training program. The commitment of resources to training differs by bank. Foreign commercial banks normally send their employees for training overseas.

2. Constraints and Issues

85. Although CBS has contributed to filling the initial capacity gap in the early stage of banking development, the scope and quality of training services are insufficient to meet the needs of the private sector, and so CBS remains as a training school for entry-level NBC employees. At this time, all CBS instructors are part-time, and salary payments still based largely on academic degrees rather than teaching ability. CBS instructors receive considerably less than those paid by the business universities. Therefore, CBS has been unable to attract a sufficient number of qualified instructors.

growth rate of 7 percent over the medium term if the governance reform programs are fully implemented. The reform scenario in the study assumes that the Government will implement full governance reform. Specifically, the reform scenario assumes the implementation of the three reforms mentioned above and a continuous flow of official development assistance.

90. **Judiciary/Legal Reform and the Development of Private Sector Framework.** Judicial/legal reforms provide an environment favorable to long-term and large-scale investment and create a level playing field for domestic and foreign investors. They also ensure the

B. Financial Sector Development Vision for 2010

1. Overview

95. With successful progress in governance reform, especially in the judicial/legal system, and the development of the private sector framework, a sound, market-oriented financial system will be in place in 10 years. A sound, market-oriented financial system is characterized as a competitive, integrated, and efficient system. Competitiveness, supported by a transparent regulatory system and the financial policy, will be the primary driving force for the development of financial system in Cambodia. An integrated financial system offers a breadth of savings and credit products that will extend economic benefits to Cambodians in lower economic strata. In turn, a competitive and integrated financial system will facilitate domestic resource mobilization

Box 1: Financial Interrelation Ratio

The financial interrelation ratio (FIR) is the ratio of the total value of all financial assets to the national wealth, which can be approximated by gross domestic product (GDP). Low FIR normally characterizes an early stage of financial development.

Source: FIR data from “The Financial Development of Japan, Korea, and Taiwan: Growth, Repression and Liberalization,” edited by H. T. Patrick & Y. C. Park, Oxford University Press, 1994.

98. The banking sector will be the prime area of growth in financial assets, followed by the

104. Regional deposit bases will expand as banks compete to establish branch networks outside urban areas. Improvement in the banking sector will create competitive pressures in the informal financial sector. This will lead to a reduction in loan margins and overhead costs for financial products and services for the rural areas and therefore facilitate integration of the formal and informal financial sectors.

105. With the promotion of the financial service outreach as well as the development of

include, for example, credit insurance, livestock insurance, and crop insurance. As per capita income grows, the demand for life insurance will gradually emerge. However, life insurance will be developed on a limited scale because of the relatively low level of per capita income over the next 10 years.

110. An enabling environment will be created for developing a multi-pillar pension system with the expansion of financial services, the strengthening of banking and insurance sectors, and the development of sound supervisory and regulatory frameworks. The current civil servant and military pension systems will be sustained over the next ten years as the foundation is established for a mandatory public pension program. At the same time, the legal and regulatory frameworks will be developed for a mandatory privately managed funded pension program and voluntary retirement savings programs.

111. With the expansion of the industry base and the diversity of products, the insurance sector will be a major contributor to domestic resource mobilization, and the domestic insurance sector will reverse the flow of premiums from overseas to the local market.

3. Development of Financial Markets and Instruments

112. With the enhancement of public confidence and competition, financial institutions will diversify financial instruments to meet the diverse needs of savers and investors. In the initial stage, the average maturity of bank assets will increase and deposit products will be further diversified. Contributing factors include (i) development of the legal and financial infrastructure, (ii) enhanced efficiency of the payment system, (iii) strengthening of law and contract enforcement, (iv) enhanced public confidence in the banking system, (v) enhanced mutual confidence between financial institutions, (vi) availability of an efficient interbank ma

123. NBC will also maintain its functional independence when conducting monetary policy. With the development of money markets and the availability of diverse financia

130. A secured transactions law and a public registry system will be in place, which will

Government accomplishes a certain development goal set in the plan earlier than planned, the policies that follow need to be adjusted accordingly.

2. Long-term Development Strategy

144. A long-term development strategy is developed to implement the financial sector vision,

(v) Sound competition in financial markets is a key driving force that leads to financial deepening by encouraging financial institutions to achieve economies of scale and scope.

(vi) A sound financial system builds on sound governance principles and strong market discipline, which supports a strong credit culture.

(vii) State ownership of financial institutions and state intervention in the allocation of

(ix) developing an efficient exit mechanism for troubled institutions to foster continuous reorganization in the financial system without incurring social costs; and

(x) systematically developing human and institutional capacity in both the private and public sectors through a public-private sector partnership.

B. The Banking Sector

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

1. Phase I: Lay the Foundation for Banking Sector Development

151. To achieve the goal in Phase I, five intermediate reform agendas are set:

(i) establishing a basic framework for monetary policy,

(ii) establishing a framework for supervision,

(iii) restructuring the banking sector,

(iv) establishing a framework for the payment system, and

(v) establishing a capacity-building mechanism.

152. **Establishing a Basic Framework for Monetary Policy**. It is imperative that monetary policy be normalized to safeguard macroeconomic stability. Considering the rampant

instrument to control riel liquidity.[13] Finally, the Government should adopt a plan to implement rediscount/refinance facilities.

153. **Establishing a Framework for Supervision.** In continuation of the current efforts, NBC needs to establish the framework for 80-1(te)1.1(e)epe an ey, cvy,(a)-5.6(y)5.7 tnsiadr icilld:c.

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banks have already adopted different systems in their automated teller machines and other services; this may incur unnecessary costs to the banking sector in establishing an integrated interbank on-line system in the near future.

156. **Establishing a Capacity-Building Mechanism.** The first step in capacity building is to establish and strengthen training institutions for both the private and the public sectors. Important activities in the private sector include (i) creation of an inclusive bankers association recognized by NBC, and (ii) establishment of a banking institute for the professional training of commercial bankers. NBC needs to strengthen its capacity-building mechanism through the following actions:

(i) appointing full-time CBS instructors under a competitive compensation scheme;

159. **Improving the Enforcement of Prudential Regulations.**

3. Phase III: Promote Efficiency through Integration and Reorganization

165. Phase III aims to promote efficiency within the banking system through the reorganization of the banking industry and further integration of the banking system. Such a goal will be achieved through six areas of intermediate reform:

(i) developing a market-based monetary policy framework,

(ii) upgrading prudential regulations,

(iii) facilitating bank reorganization through incentives and a reinforced supervision system,

(iv) establishing an integrated on-line interbank system,

(v) strengthening outreach to rural areas through competition, and

(vi) enhancing central bank independence.

166. **Developing a Market-Based Monetary Policy Framework.** In Phase III, the environment for monetary policy will improve with the deepening of the money markets and the increased efficiency of the payment system. NBC can consider introducing an open-market operation system based on available government securities. To accomplish this, NBC must develop a detailed framework for open-market operations. NBC and MEF will also need to further deepen government securities market.

167. **Upgrading Prudential Regulations.** The supervisory role of NBC must be upgraded in line with the diversification of the banking industry. For this, NBC needs to upgrade the prudential norms in accordance with the Bank for International Settlement (BIS) guidelines. Special emphasis must be placed on strengthening risk management regulations covering banks engaged in diverse nonbanking businesses.

168. **Facilitating Bank Reorganization through Incentives and a Reinforced Supervision System**. The main task of bank supervision in Phase III is to promote the reorganization of the banking sector. To this end, NBC first needs to strengthen the enforcement of PCA. Second, NBC should strengthen the incentive system by expanding the scope of nonbanking business for commercial banks that initiate voluntary mners an4cf b.em eeia222.6(1-5(he m)-5.4)-5.5(u31.3(it)-r5.9(BC n)-5.52e)1.-5.4(er-5.4(

Government must establish legal and regulatory frameworks for credit unions and cooperatives regulatory capacity, ideally ahead of the licensing of NGOs as licensed MFIs. In its supervisory and regulatory role, NBC needs to provide flexibility and room for innovation for licensed MFIs.

177. **Facilitating Institutional Transformation, Linkages, and Service Delivery.** Transformation of the six identified NGOs[14]

182. **Improving Application of Prudential Regulations.** Measures taken in this regard during Phase I will have to be effectively applied with the increase in the number of licensed MFIs. NBC will need to strengthen MSD.

183. **Establishing a Range of Service Providers.** Commercial agriculture and agriculture-related enterprises, including leasing services, will be introduced in the rural sector. Legal provisions for these will be created to support the establishment of venture capital funds and equity funds, which could facilitate the emergence of sustainable institutions by assisting NGOs to become licensed MFIs and enable restructured commercial banks to raise resources for possible incorporation as licensed MFIs.

184. **Expanding the Institutional Network.** The involvement of commercial banks in rural finance is essential to expand outreach and establish an integrated financial system. In their current financial situation, commercial banks cannot become active players in rural finance. Subsequent to their relicensing, restructuring, and possible relocation, selected commercial banks could be either designated as licensed MFIs or assisted to provide rural financial services, particularly term loans for agriculture and agriculture-related enterprises. Considering the narrow institutional base, it would be necessary to take the initiative to intervene. This could be done through the creation of new licensed MFIs, primarily in the private sector with active aid agency participation, to meet the demand for rural financial services in remote areas. During Phase II, the capacity of community groups and linkages with licensed MFIs and commercial banks will continue.

185. **Enhancing Effective Intermediation.** Building the capacity of restructured commercial banks to downscale their operations for banking with the poor and extending agricultural credit is required if these are to become active and effective participants. Similarly, intensive capacity-building support will be required for licensed MFIs for institutional and financial sustainability. [illegible]ized training institutions and/ora8rp(onal -7. e5()(a)-5cinabil) x4

1. Phase I: Establish a Foundation for the Insurance Sector and Determine the Feasibility of a Pension System.

the Government make continued efforts to further refine and improve the enforcement/ monitoring mechanism to build policyholder confidence in the compulsory insurance system.

205. **Promoting a Competitive Private Sector Insurance Market**. To develop a private competitive insurance sector, the Government must institute policies that will encourage additional private insurance companies to enter the market. To this end, the following areas need to be addressed: (i) the Government should further streamline procedures to encourage foreign insurance companies to participate in the Cambodian insurance market; (ii) the Government needs to develop reinsurance institutions through public-private partnership; and (iii) the Government must take lead in promoting private sector development by divesting its shareholdings in insurance companies to avoid conflicts of interest.

206. **Increasing Outreach to Rural Areas.** Increased outreach of the insurance sector will have a direct poverty-reduction impact on the rural areas. Competition among private insurance companies will eventually drive them to expand their business into rural areas. Although improvement in the payment system and other banking services will also create a synergic

sector partnerships that can pool resources will be essential in creating an effective and financially sustainable pension- training institution. The training institute will play a key role in capacity building for the pension system by attracting international assistance and best practices to Cambodia.

E. Nonbank Financial Institutions

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

1. Phase II: Lay the Foundation for NBFIs

219. To achieve the goal in Phase II, three intermediate development actions are set:

(i) developing the leasing business,

(ii) developing money market intermediaries, and

(iii) developing capital market intermediaries.

220. **Developing the Leasing Business.** Lease financing is an attractive alternative financial product for banks in an environment with an inefficient infrastructure to offer term finance on capital equipment. Leasing readily provides the equivalent of term loans for capital equipment to SMEs. Therefore, the Government must address the development of the leasing business geared to NBFIs. This should include adoption of specific leasing laws and regulations. Under the current Banking Law, banks are allowed to undertake leasing business, but due to the lack of implementing regulations, no banks are actually initiating leasing. Thus, NBC should first establish basic procedures for banks to undertake leasing business. The Government must also consider the framework for encouraging FDI in leasing companies with an appropriate fiscal and financial incentive system.

221. **Developing Money Market Intermediaries.** With the expansion of money markets, the Government needs to establish a legal and regulatory framework for finance companies, investment companies, and money market broker/dealers. Finance companies and other NBFIs will begin to emerge as competition among commercial banks increases. From the second phase, the banking sector will undergo reorganization as a result of competition among banks. Some banks may decide to establish a finance company subsidiary, whereas others might want to convert themselves into finance companies and specialize in a relatively narrow business.

222. **Developing Capital Market Intermediaries.** While the Government is preparing all the legal, regulatory, and institutional groundwork for capital markets, it must consider the development of capital market intermediaries. First, the Government needs to establish regulations on securities brokers/dealers, targeting the first candidate group of financial institutions. Since the Banking Law also allows commercial banks to undertake a wide range of securities businesses, they will likely become the first securities brokers/dealers. Thus, along

228. **Establishing Interbank Market Arrangements for the Banking Sector.** The first step in establishing interbank markets should be initiated by commercial banks. The establishment of an inclusive bankers association, acting on behalf of all bank members, will allow it to play a catalytic role in the formation of the interbank markets. The arrangement must be self-regulated by banks with the endorsement of NBC. The first interbank service can be short-term unsecured interbank lending (overnight call loan and money).

229. **Creating an Enabling Environment for Money Market Development**. In the first phase, the Government must put in place legal and regulatory frameworks for the development of money markets. The first task is to adopt a negotiable instruments law. The scope of the law should be comprehensive enough to include all types of instruments from simple payment instruments to credit instruments. Second, NBC should set up a regulatory framework for the interbank market activities of commercial banks. The focus of the framework, however, must be as a central bank supervisor and a monitor of the liquidity positions of the banks, as well as the overall decision-making authority for monetary policy. Third, NBC should provide detailed procedures for issuing interbank/money market instruments.

230. **Creating an Enabling Environment for T-Bills**. A key element for money market development is government securities. Thus, the Government should proactively consider the issuance of T-Bills through competitive auction. To this end, the Government needs to further scrutinize the legal/regulatory framework for the issuance of T-Bills. Furthermore, the Government also needs to adopt a medium-term plan to develop a T-Bill market, which must be geared to rationalization of fiscal management. The development of a T-Bills market should go hand in hand with necessary capacity-building activities for key staff of the National Treasury and NBC who are involved in T-Bill issuance and management.

money markets and monetary policy instruments, NBC may also consider issuing central bank

239. Capital market development cannot take place without a specific legal and institutional environment. To achieve this goal, three intermediate reforms are desired:

(i) establishing a key legal/regulatory framework,

(ii) creating an enabling environment for public bond markets, and

(iii) building capacity for future capital market participants.

240. **Establishing a Key Legal/Regulatory Framework.** In line with the establishment of

2. Phase II: Establish the Foundation for Capital Markets

243. Building on the preparatory work and achievements in the first phase, the Government can establish a securities market in the second phase. To facilitate the establishment of a securities exchange, the Government should address the following reform agenda:

(i) establishing a capital market surveillance framework,

(ii) establishing a securities exchange,

(iii) promoting the issuance of public bonds,, and

(iv) strengthening capacity building for the public.

244. **Establishing a Capital Market Surveillance Framework.** With the adoption of the securities and exchange law and its implementing regulations, the Government should establish a securities market supervision and surveillance body. The decision on the institutional modality of the capital market surveillance body must consider the availability of a critical mass of issuers, that will enable a financially independent capital market supervisor. In the initial stage of capital market development, the Government can consider two options for the supervisor: (i) a capital market surveillance unit under the related line ministry, or (ii) a full-fledged SEC. Without a sufficient number of listed companies, it would be academic to set up a full-fledged independent SEC because it could not finance its own budget. Without fiscal autonomy, the independence of a SEC can be notional. In this case, a capital market surveillance unit under the related line ministry is a realistic option in the initial stage of capital market development as the unit can benefit from full budget and administrative support. Cd Cddert96 0 TD245 ort(ne)469 TDuh[a)5.2(u)-1.5(se)12(it cou)5.2(l)
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248. With the opening of the securities exchange, one of the most critical issues in the third phase is to promote participation of both issuers and investors. To accomplish this goal, four intermediate actions are needed:

(i) strengthening capital market supervision and surveillance,

(ii) promoting capital market participation,

(iii) developing private bonds markets, and

(iv) strengthening capacity building activities for capital market participants.

249. **Strengthening Capital Market Supervision and Surveillance.** Capital market supervision and surveillance calls for extensive technical capability on the part of the supervisor. In the third phase, the Government may establish a long-term plan to build the capacity of

(i) Phase I: creating the legal infrastructure to underpin financial sector development,

(ii) Phase II: strengthening law enforcement, and

(iii) Phase III: enhancing the legal infrastructure for private sector development.

254. **Creating the Legal Infrastructure to Support Financial Sector Development**. In the first phase, the Government is expected to establish key laws underpinning financial sector and private sector development. These include civil code, company law, bankruptcy law, secured transactions law, commercial contract law, and commercial arbitration procedure. The Government should also initiate comprehensive judicial6.4(e)69(al6.(o)-5.rm2(s)-7.5(u)1.2(p)-5.2(p)-5.7(o)1.(or6.6(t)5.5dal6.4(eb(p)-5.

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259. **Strengthening Enforcement of Accounting and Auditing Standards.** In the second

facilitate domestic resource mobilization and growth-oriented investments. By 2010, Cambodia will have a banking sector, insurance sector, pension system, and nonbanking sector that together will provide a wide range of services at lower costs in both urban and rural areas. Cambodia will also develop interbank/money markets and the base for capital markets that offer various means of financial instruments to meet the demands of both savers and investors. To enable and achieve these goals, the basic legal infrastructure, a common accounting and