



Kingdom of Cambodia
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FINANCIAL SECTOR DEVELOPMENT STRATEGY*

2006-2015

Royal Government of Cambodia

* This document updates and revises the *Vision and Financial Sector Development Plan for 2001-2010* to address priorities and sequencing for the period of 2006-2015.

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PREFACE

Financial Sector has played an important role in developing the private sector and maintaining sustainable economic growth. In 2001, the Royal Government of Cambodia (RGC) adopted the *Vision and Financial Sector Development Plan for 2001-2010* (FSDP 2001-2010), which is a long-term strategy for financial sector development in Cambodia. Since that time it has served to guide the efforts of the RGC, stakeholders and development partners in defining policy and programs to support the development of the financial sector in Cambodia to achieve sound and market-based financial system.

By implementing the FSDP 2001-2010, the RGC has made some major achievements in strengthening the banking sector and developing non-banking sector such as insurance. As a result of acceleration of Cambodia's economic development and challenges faced in implementing the FSDP 2001-2010, the RGC determined to revise and update the FSDP 2001-2010 to reflect the circumstances and the need of the country.

The RGC implemented the above initiative in two stages. The first stage was the review of the current status of the financial sector in Cambodia: a stocktaking and analytical exercise as of January 2005. The results of this exercise are being published simultaneously with this document. The second stage was to revise and update the FSDP 2001-2010 as to address priorities and sequencing for the period of 2006-2015, building upon the lessons learned during the initial five years of implementation of the FSDP 2001-10 and the objectives of the RGC as reflected in the *Rectangular Strategy of Samdech Prime Minister Hun Sen*, the *National Strategic Development Plan 2006-2010* and Cambodia's Millennium Development Goals.

During the first six months of 2006, a government working group comprising representatives from the National Bank of Cambodia (NBC), the Ministry of Economy and Finance (MEF), the Ministry of Commerce (MoC), and stakeholders in Cambodia's financial sector worked closely with ADB technical team and development partners through a consultative process to develop this *Financial Sector Development Strategy 2006-15* (FSDS 2006-15). In summary, the FSDS 2006-2015 has been developed based on broad and inclusive participatory approach with all stakeholders in the financial sector in Cambodia.

The overall objective is a coherent, pragmatic and sustainable approach to financial sector development in Cambodia. At the same time, the FSDS 2006-2015 is intended to provide, in addition to guidance, a framework to support coordination and cooperation between government organs in Cambodia, between government and private sector stakeholders and actors, and between development partners seeking to support financial sector development in Cambodia.

Following the initial development process, the draft FSDS 2006-15 was released for public consultation in August 2006, particularly among Working Group on Services including Banking and Finance (Working Group E) and Working Group on Laws, Taxation and Governance (Working Group D) of the Private Sector Forum and academic. As a result of this public consultation, comments were received from a wide range of stakeholders in Cambodia's financial sector. Comments were discussed, addressed and incorporated in an appropriate manner.

The FSDS 2006-15 reflects also the efforts of the Committee for Economic and Financial Policy, the Steering Committee for Financial Sector Development and its Technical Working Group. Their inputs and responsibilities in fulfilling their mission are highly valued.

The document was presented to the Council of Ministers and duly adopted on 09th February 2007.

With its adoption, the RGC will start implementing the strategy to develop sound financial market in Cambodia in order to bring the benefits to serve the economy. The RGC is determined to take all necessary actions to establish conditions that will ensure our competitiveness relative to other financial markets.

Phnom Penh, [date]

Keat Chhon
Senior Minister
Ministry of Economy and Finance

Chea Chanto
Governor
National Bank of Cambodia

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The Royal Government of Cambodia also appreciates the FSDS technical team and the government technical working group for their efforts and contributions to developing this strategy.

ABBREVIATIONS

ABC	Association of Banks in Cambodia
ADB	Asian Development Bank
ASEAN	Association of Southeast Asian Nations
CARM	ADB Cambodia Resident Mission
CIS	Credit information system
CMA	Cambodia Microfinance Association
CPSS	Committee on Payment and Settlement Systems
CCRD	Credit Committee for Rural Development
FATF	Financial Action Task Force on Money Laundering
FSDP 2001-10	<i>Vision and Financial Sector Development Plan for 2001-2010</i> (commonly referred to as the “Financial Sector Blueprint for 2001-2010”)
FSDS 2006-15	<i>Financial Sector Development Strategy 2006-2015</i> (updating and revising FSDP 2001-10)
GIAC	General Insurance Association of Cambodia
IAIS	International Association of Insurance Supervisors
IAS	International Accounting Standards
IFRS	International Financial Reporting Standards (formerly known as International Accounting Standards)
IOSCO	International Organization of Securities Commissions
ISA	International Standards on Auditing
IT	Information technology
KICPAA	Kampuchea Institute of Certified Public Accountants and Auditors
MEF	Ministry of Economy and Finance
MFI	Microfinance institution
MIS	Management information system
MLMUC	Ministry of Land Management, Urban Planning and Construction
MoC	Ministry of Commerce
MoJ	Ministry of Justice
MoU	Memorandum of understanding
NAC	National Accounting Council
NBC	National Bank of Cambodia
NGO	Non-governmental organization
OECD	Organization of Economic Cooperation and Development
RGC	Royal Government of Cambodia
WTO	World Trade Organization

INTRODUCTION

1.01 Financial sector development is not an end in itself; rather it is one aspect supporting the development and reduction of poverty in Cambodia. There are many things that need to be done to achieve this difficult goal, but there is general agreement that accelerating and diversifying growth is key and that financial sector development supports this objective. For equitable growth, expanded finance must be accessible to the vast majority of micro, small and medium enterprises, as well as to larger and foreign enterprises. Reform and change is essential for growth. At the same time, expanding finance brings risks; hence, the context in which financial development occurs must be carefully considered, with a focus on prudential risk reduction, transparency, and uniform application of rules and regulations.

1.02 It is now well-recognized that a diversified, competitive but prudentially sound financial system plays a very important role in the development process by ensuring efficient accumulation and effective allocation of financial resources. By developing the Cambodian financial system, it will improve the process of bringing savers and investors together with those needing finance more efficiently, ultimately enhancing growth and employment creation.

1.03 The Royal Government of Cambodia (RGC), as a whole, and specifically the Committee on Economic and Financial Policy, and the Steering Committee and Technical Working Group for Financial Sector Development (see Annex I) are therefore committed to the very challenging task of establishing the fundamental basis of a developed financial sector. The task is to lay down the legal and regulatory conditions for the financial sector to expand with integrity and increased resilience. Much of the foundational work has now been completed or will soon be completed. With the establishment of the fundamental legal and regulatory framework for financial sector development and financial stability, the key tasks become particularly enforcement and transparency, in order to reduce the costs and difficulties of building long-term commercial arrangements and the financing necessary to support their development. At the same time, a continuing effort to build human capacity across the financial sector is vital in the special circumstances of the Cambodian economy and financial system. This combination of appropriate foundations, transparent enforcement and human resource development across all aspects of the financial sector will support innovation and investment in enterprises, the only path for poverty reduction and a more prosperous Cambodia.

1.04 It is therefore important to consider carefully how best to achieve the advantages of financial sector development while at the same time minimizing risks.

CHAPTER I OVERVIEW

A. Financial Sector Development Plan for 2001-2010

1.05 In 1999-2000, the RGC and the Asian Development Bank (ADB) worked together to develop a long-term strategy to develop the financial sector in Cambodia. The result, the *Vision and Financial Sector Development Plan for 2001-2010* (FSDP 2001-10)¹, was duly promulgated by the RGC, and since that time has served to guide the efforts of the RGC, stakeholders in Cambodia's financial sector, and the donor community in supporting the development of the financial sector in Cambodia. The RGC adopted the FSDP 2001-10 in a plenary session of the Cabinet meeting chaired by the Prime Minister on 24 August 2001. It is the Government's ground-breaking initiative for financial sector development.

1.06 The FSDP 2001-10:

- sets out a long-term vision and development strategy for the financial sector; and
- aims to develop a sound market-based financial system to support resource mobilization and broad-based sustainable economic growth.

To achieve the vision, the FSDP 2001-10 specifies ten guiding principles and ten elements as the Government's long-term strategy for financial sector development. Under the guidance of the long-term strategy, the FSDP 2001-10 detailed sector development strategy and policy reform agenda. The development strategy of the FSDP 2001-10 is a rolling plan, needing continuous updating to reflect the RGC's achievements, as well as the changing socioeconomic environment.

1.07 This document, the *Financial Sector Development Strategy 2006-15* (FSDS 2006-15) updates and revises the FSDP 2001-10 in a manner which seeks to be:

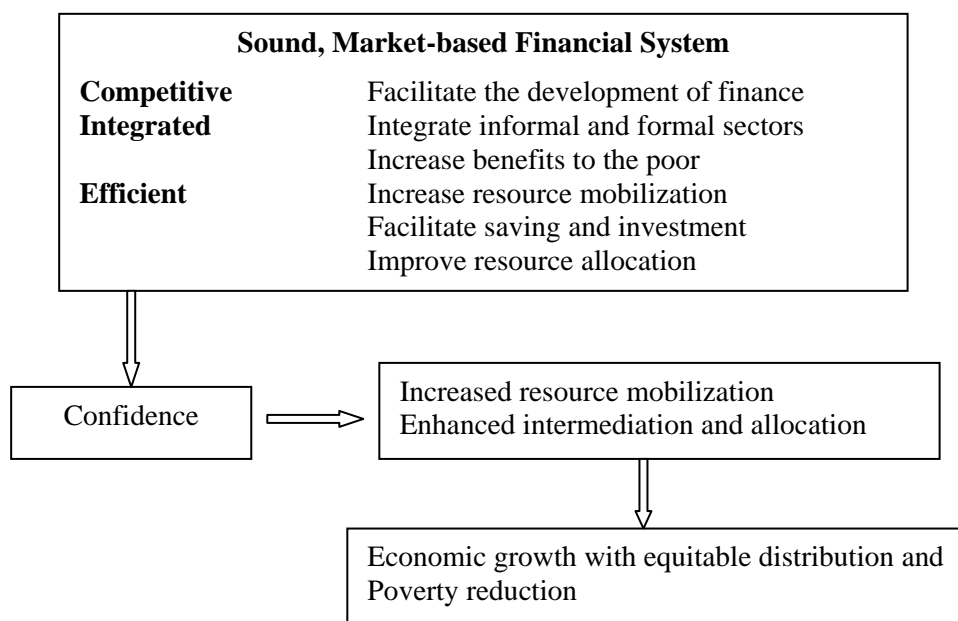
- effective in strategizing and prioritizing actions to remove the binding constraints to the development of the financial system;
- pragmatic in that it is reasonably attainable in the context of Cambodia's unique conditions; and
- sustainable in correctly sequencing financial sector reform.

B. Objective, Vision and Guiding Principles

1.08 The overall objective of the *Vision and Financial Sector Development Plan* and *Financial Sector Development Strategy* is to support the development of a sound market-based financial system to support resource mobilization, effective financial resource allocation, and broad-based sustainable economic growth.

¹ Available at http://www.adb.org/Documents/Reports/CAM_Blueprint/default.asp

Financial Sector Vision



1.09 This vision encompasses the following:

- Appropriate legal, institutional and policy foundations to promote market based finance and support good governance and the rule of law.
- A competitive, integrated and efficient banking system that is properly regulated and supervised and effectively mobilizes savings to provide financing to support economic growth, a reliable payment system and financial safety net.
- A viable, pro-poor and effective microfinance system that will provide affordable financial services to enable the poor to enhance income and reduce poverty.
- An insurance sector that protects businesses and individuals from catastrophic events and a pension system that will support retirement planning, both of which can provide capital for long-term investment.
- Financial markets which appropriately address risks, remove obstacles to financial development and support risk management and financial resource accumulation and allocation.
- Openness to financial product and institution innovation that creates more balanced financial structure, increases the depth of the financial sector, and promotes competition in the context of financial stability.

1.10 The long-term development strategy developed to implement the financial sector vision is derived from the following factors: (1) key lessons drawn from other economies' experiences with financial sector development, (2) the current situation in Cambodia's financial sector, and (3) progress in related reforms.

1.11 The experiences in financial sector reform in Asian and other economies in recent decades have been well documented by numerous studies. Sound financial sector development requires that emphasis be put on (1) foundations of finance, (2) banking and microfinance, (3) non-bank finance, and (4) general cross-sectoral considerations.

1.12 Experiences from financial sector development and reforms in Asian economies and other transition economies offer many lessons for consideration in financial sector

development in Cambodia. In drawing a long term strategy, the following 10 key guiding principles are noteworthy:

- (1) A sound fiscal policy and price stability are the preconditions for a well-functioning financial system.
- (2) The financial sector will not develop without public confidence in the protection and security of property rights and contract enforcement.
- (3) A sound financial sector cannot be created without establishing the rule of law, supported by an appropriate legal/judiciary system and law enforcement.
- (4) For efficient financial intermediation, it is necessary to develop the financial market infrastructure, particularly an accounting and auditing system, credit information system, and regulatory framework.
- (5) 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.
- (6) A sound financial system builds on sound governance principles and strong market discipline, which supports a strong credit culture.
- (7) State ownership of financial institutions and state intervention in the allocation of financial resources hinder the development of a market based financial sector.
- (8) Excessively strict entry regulation in financial industries is one factor that adversely affects financial development and the allocational efficiency of investment funds.
- (9) Lax entry requirements under a weak supervisory system results in an excessive number of poorly managed financial institutions.
- (10) For sustainable financial sector development, it is crucial to build up market-oriented management, a sound system of operations, and improvements in technical competence, commensurate with the desired change in the financial structure.

1.13 Based on the above objective, vision and guiding principles, the key elements of the long-term strategy for financial sector development adopted by the RGC are as follows:

- (1) Maintaining sound fiscal and monetary policies to ensure macroeconomic stability;
- (2) Establishing a sound legal framework to protect property rights and enforce contracts;
- (3) Establishing the rule of law through legal/judicial reform to underpin financial and commercial activities;
- (4) Sequencing efforts to develop financial infrastructure, particularly the payment/clearing system, accounting and auditing system, credit information system and regulatory framework;
- (5) Structuring the regulatory and policy framework to foster competition in the financial markets and to encourage financial institutions to realize economies of scale and scope;
- (6) Establishing a regulatory and institutional framework to promote sound governance principles and to allow market discipline to work in the management and operations of financial institutions;

- (7) Establishing a sound framework for private sector development in the financial system by phasing out state ownership and state intervention in the system;
- (8) Developing a transparent entry framework to encourage efficiency and financial deepening;
- (9) Developing efficient exit mechanisms for troubled institutions to foster continuous reorganization in the financial system without incurring social costs; and
- (10) Developing human and institutional capacity in both the private and public sectors through public-private sector partnerships.

C. Priorities for Financial Sector Development 2006-15

1.14 Since 2001, much has been achieved but much remains to be done. In updating and revising the FSDP 2001-10, the subsequent chapters of this document each provides:

- an overview of the development and current status of the financial sector in Cambodia,
- a discussion of progress in the context of the FSDP 2001-10, and
- an overview of key objectives to be addressed in the context of the period 2006-15.

1.15 The overall objective is a coherent, pragmatic and sustainable approach to moving forward in the context of the objective, vision, guiding principles and elements of the RGC's strategy to support financial sector development in Cambodia. At the same time, the document is intended to provide, in addition to guidance, a framework to support coordination and cooperation between government organs in Cambodia, between government and private sector stakeholders and actors, and between aid and advisory organizations seeking to support financial sector development in Cambodia.

1.16 The FSDS 2006-15 focuses on the following:

- Foundations of finance (chapter II)
- Banking and microfinance (chapter III)
- Non-bank finance (chapter IV); and
- General cross-sectoral considerations (chapter V).

The final chapter provides a summary matrix of the vision and priorities for financial sector development in Cambodia over the coming ten years.

1. Key Priorities: 2006-15

1.17 Under the guidance of the long-term objective, vision, guiding principles and strategy, in looking forward, the key priorities for financial sector development include:

- Improving enforcement of contracts and mechanisms for resolution of commercial disputes;
- Improving fiscal, macroeconomic and monetary policy implementation;
- Developing a safe and efficient payment and settlement system;
- Improving financial sector supervision to appropriately address risks while at the same time providing incentives for financial development and innovation; and

- Supporting human capital development and financial education across the full spectrum of Cambodia's population.

Overall, the objective is to build confidence in Cambodia's financial system, thereby encouraging formalization of finance and supporting more effective financial resource allocation, which in turn will support economic growth and poverty reduction in Cambodia.

2. Foundations of Finance

1.18 Immediate priorities relating to foundations of finance are:

- Continuing a rule of law based approach to laws and regulations relating to the financial sector through (1) public consultation relating to all draft laws and regulations relating to the financial sector, and (2) public availability of all laws and regulations relating to the financial sector through the internet.
- Completing Cambodia's commercial legal framework through the enactment of pending commercial laws and codes, including the Secured Transactions Law, Leasing Law, Insolvency Law, Commercial Contract Law, Commercial Court Law, and the Civil Code.
- Implementation and enforcement of Cambodia's commercial legal framework. This is an effective and a safe key priority. Implementation will occur through appropriate regulations, administrative systems, dissemination, curriculum development and training. Effective enforcement will require long term commitment and comprehensive legal and judicial reform. In the short to medium term, the commercial arbitration system will be developed as an additional mechanism, including through establishment of a commercial arbitration center. In addition, support for development of local dispute resolution techniques at the provincial or other levels will be explored.
- Developing and implementing a progressive company framework, with appropriate graduated requirements for small companies, other private companies, public companies limited (hereafter called "public companies"), and security-market listed companies (hereafter called "listed companies").
- Human capital development. This is an immediate and on-going need, especially in relation to financial information. In relation to financial sector human resources needs, efforts of the RGC and its agencies as well as the National Accounting Council (NAC), Kampuchea Institute of Certified Public Accountants and Auditors (KICPAA), Association of Banks in Cambodia (ABC), Cambodia Microfinance Association (CMA), and General Insurance Association of Cambodia (GIAC) are to be encouraged and supported. In addition, efforts are needed to support development of tertiary and public education and awareness.
- Land and real property registration. Completing land and real property registration is a long term objective which will take years to complete. At the same time, attention should now be focused on areas which are or are likely to experience increasing numbers of transactions and therefore raise the potential for conflict. Examples are the major urban areas, where registration needs to be completed as an immediate priority, as well as development of appropriate regulatory systems to support real estate transaction services.
- Continuing public financial management reform.
- Improving monetary policy instruments and develop market based monetary policy framework. This will require supporting the development of the payment system and money / interbank markets including short term government securities.

1.19 Intermediate and medium term priorities and longer term goals are:

- Completing the land and real property registration process. This may not be completed by 2015 but is a significant on-going priority to support financial development.
- Supporting development of real estate markets.
- Enforcement of contracts and the rule of law. Improving the ability of the judicial system to consistently enforce contracts and fairly resolve commercial disputes requires continuing long term effort. In the medium term, establishing a commercial court system in addition to the commercial arbitration system will provide another mechanism through which enforcement of commercial contracts and commercial dispute resolution can be improved. The commercial court system will be designed to operate according to the principles of the rule of law.
- Continued public financial management reform.
- Monetary development: Increasing confidence in the domestic currency and its use. On this basis, a fiscal incentive framework will be implemented, including payment of government salaries and other expenditures in riel through bank accounts and the payment system, and requiring tax and other government payments likewise to be made in riel through the payment system. As demand increases, larger denomination notes will be issued.

3. Banking and Microfinance

1.20 The key priorities for supporting the development of banking and microfinance in Cambodia are:

- Identifying and appropriately addressing risks.
- Improving financial institution operations and increasing intermediation through human capital development, education and appropriate regulation and supervision.
- Increasing confidence through improving financial institution and supervisory functioning and education.
- Formalizing finance through increasing confidence.
- Linking banking and microfinance through increasing confidence in regulation, supervision and enforcement and developing appropriate financial infrastructure especially the payment system, money / interbank markets including short term government securities, and improving financial information quality and transparency.
- Treating providers of similar financial services similarly to provide a level playing field and avoid regulatory arbitrage and providing a progressive, developmental system for non-banks conducting banking type activities.

3.1 Banking

1.21 In looking forward, the key objectives are to:

- Address issues relating to the preconditions for banking operations and supervision, relating especially to developing systems to deal with problem bank resolution and insolvency, and developing an effective, efficient and safe national payment and settlement system.
- Continuing to improve both the legal and regulatory framework for banking supervision and banking supervision itself, both with the overall objective of

supporting financial stability and banking sector development to improve economic growth and reduce poverty.

1.22 The immediate priorities are:

- Continuing improvement of supervision, capacity building at NBC and banks, and customer education and awareness activities.
- Automating cheque clearing and settlement.
- Development of national wholesale electronic payment system including support for the interbank market, initially with banks and specialized banks as participants.
- Bringing money lenders and changers into the formal regulatory framework, through appropriate registration and filing requirements.
- Comprehensive development of NBC information technology (IT) and management information systems (MIS) to support functions.
- Strengthening NBC and judicial implementation/enforcement.

1.23 The intermediate and medium term priorities are:

- Expanding payment system access to licensed MFIs.
- Providing collateralization of payment system exposures through short term government securities.
- Continued capacity building at NBC and banks.
- Customer education and awareness activities.
- Continuing improvement of supervision.
- Moving the inter-bank credit information system into the private sector, including establishing the necessary supporting legal and regulatory framework to support its functioning.
- Supporting development of new financial products / activities in the context of equal treatment of providers and financial stability. This will include regulating money lenders and changers to the extent they are conducting banking business.

1.24 The longer term objectives include

- Comprehensive review of banking law and regulations to update / improve as necessary.
- Undertaking a review of the depositor protection system and addressing deficiencies.

3.2 Microfinance

1.25 Macro level priorities involving Government and regulatory authorities are:

- Continued development of capacities at NBC for effective regulation and supervision of the microfinance sector. The sector's requirements are, in many ways, different from those of the commercial banking sector, since the requirements for support are more extensive.
- Agreement upon common reporting standards to establish sound financial performance analysis and enable the support of the sector's growth, as well as to inform the public.
- Addressing structural risks associated with microfinance institutions (MFIs), in terms of governance, ownership, and the small size of some MFIs.
- Improving statistical analysis and market definitions.

- Creation of capabilities to support other forms of microfinance institutions i.e. community-based, non-registered, etc. to broaden the types of needs being met, and introduce greater variety and flexibility into the system.

1.26 Meso level priorities at the technical support level are:

- Establishment of a microfinance sector training facility.
- Improvement of the provision of MIS for MFIs, including minimum standards.
- Development of the money / interbank market to include participation of licensed MFIs.
- Support for development of the Cambodian Microfinance Association (CMA).
- Build a local MFI ratings capacity, based upon commercial ratings support and also linked to a credit information exchange.
- Support continued development of participating capital / equity investment from internal and foreign investors for MFIs.

1.27 Micro level (retail) priorities are:

- Supporting the strengthening of retail institutions, particularly those below the level of licensed MFIs.
- Based upon research and statistical analysis conducted at the Macro level, a need may arise to assist other forms of microfinance institutions (non-registered, community based, etc.), and to ensure that where needs are being met by such ad hoc organizations, those needs continue to be met. The greater the variety and flexibility in the system, the stronger it will be.
- Support for development of further links between NGOs dealing with the destitute and MFIs. This will allow destitute people who become non-destitute, via NGO support, to ease into the microfinance sector.

4. Non-Bank Finance

1.28 In looking at non-bank finance, the priority areas are insurance and financial markets.

4.1 Insurance

1.29 Immediate priorities are:

- Review and upgrade the regulatory system so as to conform to developing international and regional standards;
- Adopting appropriate financial reporting standards for insurance companies;
- Supporting supervisory development;
- Privatization of CAMINCO;
- Improving inter-ministerial collaboration;
- Developing framework for micro-insurance;
- Supporting the development of life insurance through feasibility studies; and
- Develop appropriate strategy for life insurance development, including necessary elements of legal framework.

1.30 Intermediate and medium term priorities are:

- Continuing to support development of life insurance through enactment and implementation of an appropriate legal and regulatory framework;

- Improving actuarial capacity and related requirements;
- Development of an insurance training institute;
- Improving consumer protection and customer awareness;
- Supporting standardization of policy wordings and relevant requirements; and
- Feasibility study into the development of a private, voluntary pensions system in Cambodia.

1.31 Longer-term goals are:

- Implementing the social security law, and issuing appropriate supporting instruments.
- Developing a regulatory system to deal with private pensions. It will be necessary to include vesting rules for employer contributions; funding requirements for guaranteed benefits; actuarial certification for defined benefit plans; investment rules that stress yield without sacrificing safety and necessary liquidity.
- Examining the advantages of including a mandatory savings plan for formal sector workers, perhaps as a part of the social security system.

4.2 Financial Markets

1.32 In relation to money / interbank markets, immediate priorities are:

- Development of national wholesale payment system.
- Continued public financial management reform under the lead of the MEF.
- Electronic government securities system linked to the secured transactions registry, capital requirements for financial institutions and national wholesale payment system, under the supervision of NBC. Development can begin with issuance of short term bills and notes (less than one year in duration, beginning with 30 day notes).

1.33 In relation to money / interbank markets, intermediate priorities are:

- Continuing to enhance public financial management reform.
- Extending maturity range of government securities on the basis of appropriate advice and preparation.
- Considering allowing regulated financial institutions initially banks, then extending to licensed MFIs to offer short term paper (one year or less) through the government securities system, thereby forming the basis of a true money / interbank market.

1.34 In relation to capital markets, immediate priorities are:

- Development of appropriate regulatory framework, including enactment of the Insolvency Law, development of the progressive graduated framework for companies addressing small companies, other private companies, public companies and listed companies.
- Enactment of Law on Non-Government Securities providing an enforcement framework and an appropriate enforcement authority for financial fraud, pyramid schemes etc. in line with international standards, and a central electronic securities depository for all public companies linked to the secured transactions registry.
- Continuing improvement of accounting / auditing capacity.
- Public awareness, investor education and human resource development to support financial market development while reducing the scope for and vulnerabilities to market misconduct.
- Establishing a partnership with a foreign securities exchange to assist in developing domestic capital markets.

- 1.35 In relation to capital markets, intermediate priorities are:
- Implementing the progressive graduated framework for companies.
 - Securities depository for all public companies in operation and public company registration opened. This will establish the foundation of a possible public securities exchange, and will include real name registration, price data, and both debt and equity securities of public companies, and essentially operate as an over-the-counter (OTC) public company securities market.
- 1.36 In relation to capital markets, medium term priorities are:
- Implement the enforcement and regulatory system through an appropriate agency.
 - Continue to support the development of financial information and companies.
 - Consider establishing a formal securities exchange on the basis of the public companies securities depository, with a feasibility study as the first stage.
 - Public offerings of securities only permitted through a formal securities exchange and only by public companies including for investment funds. Private offerings will be permitted by public companies as well as by listed companies.
 - Design of investor compensation scheme to address risks of failure of securities intermediaries holding client assets.
- 1.37 In relation to capital markets, longer term considerations are:
- Investment funds.
 - Pensions. In line with the suggestions in Insurance, Cambodia will consider developing a three pillar pension system, including possibly a provident fund scheme similar to those of other countries particularly in Asia.
 - Securitization. In seeking longer term financing for infrastructure and other sorts of development, Cambodia may consider developing an appropriate framework to support securitization. Such a framework may include a securitization institution (such as a mortgage corporation).
 - Derivatives. As macroeconomic, monetary and fiscal frameworks improve and the use of the riel increases, Cambodia may consider allowing the development of certain types of derivatives to assist in risk management.

5. General Cross-Sectoral Considerations

5.1 Liberalization and competition

- 1.38 Immediate priorities are:
- Continued implementation of WTO and ASEAN financial sector and related commitments.
 - Development of Competition Law and policy, taking account of the special needs of the financial sector by requiring consultation with the appropriate regulatory agency in addressing competition questions in the financial sector.
- 1.39 Intermediate and medium term priorities are:
- Implementation of Competition Law and policy through an appropriate institutional and enforcement framework, including cooperation and consultation with financial regulatory agencies in situations involving financial services and financial institutions.

- Continued participation in and support for ASEAN regional financial market development activities.

1.40 Longer term goals include encouraging other ASEAN and WTO members to liberalize by matching Cambodia's financial sector commitments, thereby bringing benefits not only to Cambodia's financial sector but also to Asian financial development.

5.2 Financial Innovation

1.41 Immediate priorities are:

- Allowing establishment of new financial institutions which meet relevant licensing, authorization and operational requirements.
- Supporting a permissive approach to financial products and services in the context of addressing risks.
- Finalizing the legal and regulatory framework for leasing.
- Clarifying approach to financial institution activities, especially in the context of banks and insurance companies, and formalizing this understanding through Memoranda of Understanding (MoUs) between the regulatory agencies involved.

1.42 Intermediate priorities include developing a permissive approach to financial product development based upon the experiences gained in the context of leasing.

1.43 Longer term goals include:

- Developing legal and regulatory framework as necessary to support financial product and service innovation; and
- Developing a clear approach to financial institution activities and financial conglomerates, supported by appropriate legal and regulatory framework or MoUs as necessary.

5.3 Financial Regulatory Structure

1.44 Immediate priorities are:

- Clarifying permitted financial institution activities and approach, having special regard to the systemic risks posed by banks and banking activities.
- Consideration of appropriate arrangements for responsibility for financial sector policy development.
- Supporting as necessary through changes to the legal and regulatory framework or MoUs.

1.45 Intermediate and medium term priorities include:

- Comprehensively evaluate financial regulatory structure in the context of financial institution activities and financial conglomerates and domestic regulatory and supervisory capacity.
- Implement necessary changes to regulatory structure resulting from the comprehensive evaluation.

1.46 Longer term goals include a comprehensive financial sector assessment and review.

CHAPTER II

FOUNDATIONS OF FINANCE

2.01 Since 2001, Cambodia has made significant progress in establishing the basic policy, institutional and legal framework for the financial sector and economic growth generally. The FSDP 2001-2010 identified three main foundations of finance: (1) the legal framework for commercial and financial transactions; (2) accounting and auditing standards; and (3) financial market information infrastructure.

2.02 Under this framework, the legal framework for commercial and financial transactions included company law, insolvency law, secured transactions law, civil code and procedure, and courts and commercial court. Cambodia enacted its first comprehensive company law (the Law on Commercial Enterprises) in 2005 and a new Civil Procedure Code in 2006. In addition, the Secured Transactions Law is undergoing parliamentary review, with enactment in the near future likely. At the same time, an Insolvency Law and the new Civil Code are nearing completion. The MoC has established a company registry, and will launch an on-line secured transactions registry soon after the Secured Transactions Law is enacted. At the same time, while the basic legal framework is or will soon be in place, the court system is still not strong in the context of enforcing contracts and resolving commercial disputes, thereby undermining the effectiveness of the emerging commercial legal framework.

2.03 In relation to accounting and auditing standards, the FSDP 2001-10 specified, first, a law and, second, standards based upon International Accounting Standards (IAS) which is now known as International Financial Reporting Standards or IFRS and International Standards on Auditing (ISA). The Law on Corporate Accounts, their Audit and Accounting Profession has been enacted under the responsibility of the MEF, and the NAC has been established to set accounting and auditing standards. Standards based upon IAS and ISA are being implemented and significant progress is being made in developing qualified accountants and auditors, with KICPAA playing an important role.

2.04 In relation to financial market information infrastructure, the FSDP 2001-10 identified primarily the need to develop a credit information system. In this context, NBC and the ABC launched a new inter-bank credit information system in August 2006 allowing inter-bank transfer of credit information on clients.

2.05 Since the development of the FSDP 2001-10, understanding of the key foundations of financial sector development and economic growth has advanced. Today, three foundational aspects of finance can be identified which need to be addressed in order to support financial sector development:

- Preconditions for financial development and economic growth;
- Institutional underpinnings of finance; and
- Financial market infrastructure.

These areas interact closely with financial market regulation and development, especially in relation to banking and microfinance (chapter III), non-bank finance including insurance and financial markets (chapter IV), as well as with liberalization and competition (chapter V, General Cross-Sectoral Considerations).

2.06 These foundations and the financial sector specific guidance addressed in subsequent sections are in turn reinforced by an appropriately sequenced policy of liberalization and competition.²

A. Preconditions for Financial Development and Economic Growth

2.07 Preconditions for financial development and economic growth comprise four elements which serve as the essential foundation of a market based economy:

- Effective governance;
- Property rights and their protection;
- Enforcement of contracts and resolution of commercial disputes; and
- Human capital development.

1. Governance

2.08 For any economy to develop beyond the simplest level, it must have a functioning governance system which provides a minimal level of political stability and security. Since 1993, Cambodia has made significant progress on this most basic foundation stone of economic development. Overall, governance is improving in Cambodia but requires continuing attention, especially in relation to second level issues such as fiscal sustainability.

2. Property rights and their protection

2.09 For a market economy to function, there must be property rights and those property rights must be protected and enforced. Property rights should cover real property including land and buildings, moveable property such as vehicles and personal property and intangible property (such as rights to use property and intellectual property). Once again, Cambodia has made significant progress on this essential foundation of financial and economic development, especially in relation to land and property registration. Overall, the land registration is proceeding, though final completion will take years. In addition, the Law on Copyright and Related Rights which was enacted in 2003 provides the basis for intellectual property protection. In looking forward, there is a priority need to focus on completing the land and property survey and implementing systems to protect ownership of both real and intellectual property.

3. Enforcement of contracts and resolution of commercial disputes

2.10 For commercial dealings to advance beyond instantaneous transactions, there must be a system for enforcing contracts and resolving commercial disputes. At the moment, Cambodia's court system does not fulfill this function consistently. At the same time, a new Commercial Arbitration Law was enacted in 2006, and this may provide an alternative framework to address this fundamental need in Cambodia's financial and economic system at

² See chapter V.

the same time as the court system is strengthened to the level necessary to generate confidence in its ability to consistently enforce contracts and fairly resolve commercial disputes. In strengthening the court system's effectiveness in handling commercial disputes, the Commercial Contract Law will be enacted and a commercial court system will be developed and operate under a rule of law framework. In addition, support for development of local dispute resolution techniques at the provincial and other levels will be explored.

4. Human capital development

2.11 Cambodia's financial development has been and continues to be significantly affected by human capital constraints resulting from its historical development over the past half century or so. Progress is being made, with improvements to education at the primary, secondary and tertiary level, as well as the development of professional programs such as those relating to accounting and auditing. Clearly, however, this foundation requires continuing and long-term efforts. In every aspect, dissemination activities, curriculum development, and training are required. Specific areas of concern include improvements in providing practical education regarding Cambodian Accounting Standards and tax law. This also extends more widely to efforts directed towards consumer education regarding the benefits of formal finance while at the same time raising awareness of potential risks.

B. Institutional Underpinnings of Finance

2.12 Institutional underpinnings of finance build upon the preconditions for financial development discussed above, and comprise:

- Collateral, secured transactions and leasing;
- Company law;
- Sustainable fiscal and taxation system;
- Macroeconomic and monetary policy and related institutional framework; and
- Rule of law.

The institutional underpinnings are the second stage of development once the initial preconditions are largely in place. At the same time, the institutional underpinnings are essential for effective financial intermediation to develop.

1. Collateral, secured transactions and leasing

2.13 Once there exists a system of property rights and mechanisms for their protection, it is necessary to provide mechanisms through which those property rights can be used for finance. These come in two primary forms: collateral structures such as mortgages and secured transactions, and leasing.

2.14 The framework for secured transactions enables property rights including real property such as land or moveable property such as vehicles to be used as collateral support for borrowing. In Cambodia, the Land Law includes provisions on mortgages which are supporting the use of real property and real property rights as collateral. At the same time, it will be necessary to develop an appropriate legal and regulatory framework to support property valuation, real estate transaction services and the real estate market. In addition, a

new Secured Transactions Law will be enacted soon and will be supported by a modern, secure and efficient registration system addressing property other than real property. This system will require significant effort to support on-going development, including regulations, training and administrative support.

2.15 Leasing is another mechanism which enable property rights to be used to support economic mobilization through finance. Leasing transactions allow assets to be used to generate income producing activities by the user while at the same time protecting the property rights of the owner. Cambodia will soon enact a Leasing Law to support such transactions and protect property rights and interests of those involved, as well as appropriately address any risks to financial stability. At the same time, much will be required to support implementation of the new system, including regulations, training and administrative support.

2. Company law

2.16 In order to amalgamate financial resources, it is necessary to have a legal framework for companies. As noted above, Cambodia in 2005 enacted its first comprehensive Law on Commercial Enterprises, addressing business entities, including companies. The registration system has been established at the MoC and is being improved so that it is now less costly and cumbersome to register, with increasing numbers of enterprises registering as companies and moving from the informal to the formal economy.

2.17 With the enactment of the Law on Commercial Enterprises and the improvement of the company registration system, the next level of attention will focus on improving the environment for companies to support resource mobilization, especially insolvency, financial information and corporate governance. Further, the system needs to provide an integrated, progressive, graduated, developmental, incentive-based framework to support company growth and expansion. Essentially, this framework should address requirements for:

- Small companies: Small companies currently being registered in increasing numbers will have simple filing and financial information requirements, as well as simple systems of taxation, corporate governance and insolvency. This has been initiated by new regulations from the MEF.
- Other private companies: As companies grow larger but still with 30 shareholders or less, they will have higher filing and financial information requirements, as well as more sophisticated rules regarding taxation, corporate governance and insolvency.
- Public companies: General registration of public companies (those with more than 30 shareholders and/or whose securities may be sold to the public) will not be permitted until an effective regulatory framework is established, including financial information infrastructure, corporate governance and insolvency systems. Likewise, a central securities registry for all public companies including real name security owner registration will be established before new public companies are permitted to be formed.
- Listed companies: Depending on market demand, Cambodia may have companies with securities listed on an exchange and offered for sale to the public in the future. Clearly, these sorts of companies will have high standards for filing and financial information requirements, as well as taxation, corporate governance and appropriate insolvency arrangements.

3. Sustainable fiscal and taxation system

2.18 An effective, transparent and sustainable fiscal system including taxation is necessary for a government to be able to provide necessary public goods including enforcement of contracts, commercial dispute resolution and protection of property rights, as well as maintaining public order and stability. Such a system is also important in addressing issues of corruption.

2.19 Cambodia, under the auspices of the MEF, has made progress in simplifying taxation with filing has been simplified through the issuance of new Annual Tax Returns, and is working to build a sustainable fiscal position for the government, but is not yet to the point of fiscal sustainability. There is need for continued simplification of the taxation system and enhanced enforcement to expand the range of taxpayers improving tax collection to increase government revenues to a sustainable level to support expenditure.

2.20 In looking forward, the MEF will continue to lead efforts in the area of public financial management reform in line with relevant international experience and standards.

4. Macroeconomic and monetary policy and related institutional framework

2.21 Macroeconomic and monetary policy must be stable and appropriate, and supported by an effective institutional framework. In relation to policy, the key focus is on price stability, monetary stability and financial stability. Financial stability is advanced more directly below in the context of Banking and Microfinance (chapter III) and Non-Bank Finance (chapter IV). In relation to macroeconomic policy, Cambodia is constrained by its dollarized economy, especially in relation to monetary policy. At the same time, use of the US dollar has also been effective in supporting macroeconomic stability.

2.22 In looking at the development of Cambodia's financial sector, the basic institutional framework is in place for safeguarding macroeconomic stability. The basic institutional framework provides the basis on which a more efficient and effective monetary policy for safeguarding macroeconomic stability can be implemented. In order for this to occur, there is a need to develop appropriate instruments and tools.

2.23 In moving forward, Cambodia will continue to be guided by relevant international experience and standards in the area of macroeconomic policy and the related institutional framework.

2.24 Beyond this, the immediate priority to set up a system for an effective and efficient monetary policy is first to improve monetary policy instruments, and, second, to develop a market-based monetary policy framework. As stated in the FSDP 2001-10, the improvement of monetary policy instruments will lead to increasing competition among banks, enhancing their intermediation function. At present, the key needs are:

- **Payment system.** Unless the payment system is well developed, the effectiveness as well as the efficiency of monetary policy is not attainable. The main objective, thus, is to achieve the establishment of a payment system, which is secure and safe, and has a

national dimension. In addition, it is expected to have an electronic payment system both for riel as well as for the US dollar.

- **Money / interbank / government securities market.** Financial markets serve as another important component of the macroeconomic policy framework, shaping a market-based monetary policy. The establishment especially of money / interbank markets including short-term government securities³ will assist flows of financial resources, and provide the NBC and RGC with important information and means of macroeconomic management.

2.25 The establishment of an effective payment system and of a money / interbank market including short-term government securities paves the way not only for a market-based monetary policy, but also promotes monetary development, a medium and long term priority for Cambodia.

2.26 Monetary development and increasing the use of the riel is also supported by increasing public confidence. As confidence in the government, the financial system and financial institutions improves, and once a payment system is developed, confidence should also develop in the domestic currency. As the infrastructure is developed, government salaries and other expenditures can be paid through the payment system into bank accounts, and tax and other government revenues can be paid in riel through the banking and payment system. This can eventually be extended to all salaries once the financial system has developed sufficiently. As such confidence increases, larger denomination notes in riel could be issued to enhance the effectiveness of the riel as a means of exchange. At this point, prices could also be expressed in riel. Further, as confidence in the currency increases and use of the currency increases, the tools available for implementation of macroeconomic and monetary policy will improve.

5. Rule of law

2.27 For finance to develop beyond simple, short term and mainly cash based transactions, it is necessary to have a rule of law system for finance and commerce. In the financial context, the rule of law is more than consistent enforcement of contracts and fair resolution of disputes. Rather, it extends to the nature of the legal system in place in a given country. In order to support intermediate levels of financial development, law must be:

- created by a legitimate authority, certain, clear, publicly accessible, mutually consistent, prospective and able to be obeyed;
- applied through transparent processes, principled reasoning and subject to organized appeal;
- interpreted and monitored by an independent judiciary free of political control; and
- congruent with the behavior of administering officials.

2.28 At present, as noted above, there is uncertainty and lack of confidence in the court system's role in enforcing contracts and resolving commercial disputes. These aspects must be addressed, through the development of the commercial arbitration system, support for other alternative dispute resolution mechanisms, and the commercial court system. At the same time, for the financial system to deliver maximum benefits, reform must focus on the four elements above highlighted in relation to developing the rule of law in the context of the

³ See chapter IV, Non-bank Finance: Financial Markets.

financial sector. Over the medium to longer term, Cambodia is committed to implementing the rule of law. This however will require extensive administrative and judicial reform, commitment and resources to achieve, but in the long run will provide huge support for financial development, economic growth and poverty reduction.

2.29 Cambodia will continue to improve transparency and legitimacy in the financial sector through public consultation on all draft laws and regulations relating to the financial sector. In addition, all laws and regulations related to the financial sector will be publicly available through the internet. Not only will this support the development of the rule of law in the financial sector but it is also important in the context of Cambodia's WTO commitments and related transparency obligations. As a second stage, Cambodia will continue the process of establishing specialist commercial courts designed to operate under rule of law principles. Over the longer term, Cambodia will work to develop its entire legal and administrative system to operate under rule of law principles.

C. Financial Market Infrastructure

2.30 On the basis of the preconditions and institutional underpinnings, basic financial transactions and development can occur, and this is in fact the situation in Cambodia at the present. At the same time, to move towards more sophisticated forms of intermediation and resource mobilization and allocation, more sophisticated legal and institutional infrastructure for finance needs to be developed. This very much describes the present circumstances in Cambodia. This financial market infrastructure needs to address the following:

- Insolvency;
- Financial information;
- Corporate governance;
- Payment and settlement system;
- Corruption and market integrity; and
- Government securities markets.

1. Insolvency

2.31 Once a country has a company law, it also needs to address company failures – an event certain to occur in any market economy – through the development of a system to deal with insolvency. At present, Cambodia is in the process of enacting its first Insolvency Law in line with international experiences and standards. The next stage will be the related administrative systems necessary to make such law functional. This will require appropriate regulations, support for professional and administrative development, dissemination activities, curriculum development and training.

2. Financial information

2.32 In order for financial transactions to move beyond basic collateralized or relationship based lending, appropriate systems for financial information must be developed, especially those relating to accounting and auditing. In addition, credit information systems for lending and credit rating agencies are also useful. Cambodia has enacted its first Law on Corporate

Accounts, their Audit and Accounting Profession, established NAC as the standard setter and KICPAA as the related professional body, and established accounting and auditing standards based upon IAS. At the same time, it is also making progress in human capital development to support these systems. An inter-bank credit information system (CIS) was launched in August 2006. This has been coordinated and supported by NBC and will become a private concern as it becomes financially sustainable, with expanded access including for licensed microfinance institutions (MFIs). In addition, credit rating agencies may be useful to improve the credit culture and as financial markets develop.

2.33 In this context, further support will be required for accounting and auditing standard development and related regulations, as well as dissemination, curriculum development and training. Developing and transferring the inter-bank CIS to the private sector will require legal and regulatory development as well as dissemination and training.

3. Corporate governance

2.34 For companies to serve as mechanisms to amalgamate capital from larger numbers of investors, that is, moving beyond private companies with 30 or fewer shareholders to public companies with larger numbers of shareholders and eventually listed companies selling securities to the public, parallel mechanisms for corporate governance must also be developed in line with international standards such as the *Principles of Corporate Governance* of the Organization of Economic Cooperation and Development (OECD). General registration of new public companies will commence once the appropriate regulatory framework is in place. Development of the regulatory system will require extensive effort.

4. Payment and settlement systems

2.35 Payment and settlement systems are necessary for the development of money / interbank markets and for mobilization of resources through the financial system, as well as supporting macroeconomic policy implementation. At present, Cambodia is a largely cash based economy with no formal wholesale payment or settlement system except for limited though increasing numbers of cheques in both riel and US dollars. This is a key impediment to financial development in Cambodia, and a key priority in the FSIDS 2006-15. At the same time, the Negotiable Instruments and Payments Systems Law was enacted in 2005, and this provides for the first time the comprehensive legal framework for the development of negotiable instruments such as cheques, bills of exchange, promissory notes, and the regulatory framework for a formal wholesale payment system. These issues are dealt with in greater detail below in the context of Banking and Microfinance (chapter III).

5. Corruption and market integrity

2.36 Mechanisms to address corruption and market integrity are now seen as key to financial development. Market integrity focuses largely on money laundering and related flows of money arising from illicit activities. At present, Cambodia is in the process of implementing a comprehensive system to address money laundering. In addition to money laundering, market integrity also includes protection against financial fraud and crime. These

issues will require extensive effort as Cambodia's financial sector develops and are addressed in the context of chapter IV.

2.37 In relation to money laundering and market integrity, the primary international guidance is that from the Financial Action Task Force on Money Laundering (FATF). Cambodia is implementing FATF principles and will continue to exert its best efforts to combat money laundering and terrorist financing, focusing on "know your customer" and reporting of suspicious transaction requirements across the financial sector.

2.38 In addressing corruption concerns, based on experiences around the world and especially in Asia, a number of major steps can be identified:

- Fiscal improvement and sustainability. Corruption can be the result of low public pay levels. Before a government can improve public sector pay levels, it must be able to generate sufficient and sustainable revenue through a sustainable, simple taxation and fiscal regime. These issues are being addressed through public financial management reform under the lead of the MEF. In this context, a tax regime that can be obeyed and that requires reasonable levels of payment also encourages respect for the government and the law.
- Increasing government salaries, especially those of the judiciary, to a reasonable level once fiscal sustainability has been achieved in order to reduce incentives for official corruption. Judicial salaries have been increased and efforts are being made in the context of public financial management reform to address government finances and sustainability.
- Laws on corruption combined with an amnesty for pre-existing offences. At the same time as public sector pay levels are increased, tough laws on corruption also need to be enacted in line with international standards such as the OECD Convention on Bribery of Public Officials and the WTO procurement codes. An anti-corruption law will be enacted in the near future.
- Independent anti-corruption enforcement authority. At the same time as anti-corruption laws are enacted and the amnesty period is triggered, an independent corruption investigation and enforcement authority needs to be established in order to implement the new system. A Supreme Council on Anti-Corruption has been established and is working on the appropriate legal framework and related systems.

2.39 Cambodia is committed to addressing issues of corruption in the context of international experiences and standards.

6. Government securities markets

2.40 Once a government has developed a sustainable fiscal and taxation system, it may consider developing government securities markets. Law on Government Securities was adopted on 30 November 2006. Government securities markets, in addition to assisting with government liquidity management through regular offerings of short term government securities also support the functioning of the payment and settlement systems by providing means to secure payment exposures prior to final settlement, macroeconomic and monetary policy, and provide key information to financial sector participants through the development of a yield curve. Further, once short term government securities markets are functioning and providing an effective yield curve, the government may be able to extend the tenor of its borrowing, thereby providing a means of longer term financing as well as support for

investment opportunities. These issues are dealt with in more detail in the context of Non-Bank Finance: Financial Markets (chapter IV).

D. Strategy for Financial Sector Development: Foundations of Finance

2.41 In looking forward, this section will highlight key challenges in relation to the foundations of finance in the context of international experience and standards.

1. Immediate priorities

2.42 Immediate priorities relating to foundations of finance are:

- Continuing to support a rule of law based approach to the development and availability of laws and regulations relating to the financial sector through (1) public consultation relating to all draft laws and regulations relating to the financial sector, and (2) public availability of all laws and regulations relating to the financial sector through the internet.
- Enacting pending commercial laws and codes, including the Secured Transactions Law, Leasing Law, Insolvency Law, Commercial Contract Law, Competition Law, Commercial Court Law, and the Civil Code. Other laws to be considered include laws on agency and franchising.
- Implementing new commercial laws through appropriate regulations and administrative support services such as filing offices and registration / licensing systems as well as dissemination, curriculum development and training activities. This will be supported by the establishment of a Commercial Law and Document Center. Implementation activities will be required for the Law on Commercial Enterprises, Secured Transactions Law, Leasing Law Insolvency Law, Commercial Contract Law and the Civil Code, among others such as agency and franchising. Other areas of concern include property evaluation and real estate transactions.
- Enforcement of Cambodia's commercial legal framework. This is a key priority. However, it is not one that is easily achieved and that will require long term commitment and legal and judicial reform. In the short to medium term, an alternative may be provided through the development of the commercial arbitration system. Developing commercial arbitration on the basis provided by the Commercial Arbitration Law is therefore an immediate priority. Such development will include the development of necessary regulations and administrative support services, a Commercial Arbitration Center as well as dissemination, curriculum development and training activities. In addition, support for development of dispute resolution techniques at the provincial and other levels will be explored.
- Developing and implementing a progressive company framework, with appropriate graduated standards for small companies, other private companies, public companies and listed companies. This is further discussed in the context of Non-Bank Finance: Financial Markets (chapter IV).
- Human capital development. This is an immediate and on-going need, especially in relation to financial information. Development of the progressive company framework should also provide demand side incentives for individuals to develop their financial information expertise and related qualifications, as differing levels will

be required for companies at different stages of development. Human capital development will be supported by appropriate dissemination, curriculum development and training activities across all aspects of the financial sector.

- Land and real property registration. Completing land and real property registration is a long term objective which will take years to complete. At the same time, attention should now be focused on areas which are or are likely to experience increasing numbers of transactions and therefore raise the potential for conflict. Examples are the major urban areas, where registration needs to be completed as an immediate priority. Other areas of concern include development of appropriate legal support for real estate business.
- Continuing public financial management reform.
- Improving monetary policy instruments and develop market based monetary policy framework. This will require supporting the development of the payment system⁴ and money / interbank markets including short term government securities.⁵

2. Medium and Long Term Priorities

2.43 Medium and long term priorities relating to foundations of finance are:

- Completing the land and real property registration process. This may not be completed by 2015 but is a significant on-going priority to support financial development. In addition, developing an appropriate framework to address real estate valuation and sales practices will support market development.
- Enforcement of contracts and the rule of law. Improving the ability of the judicial system to consistently enforce contracts and fairly resolve commercial disputes requires continuing long term effort. In the short term, this will be enhanced through the development of commercial arbitration, support for the development of provincial dispute resolution mechanisms and implementation of the Commercial Contract Law. In the medium term, establishing a commercial court system in addition to the commercial arbitration system will provide another mechanism through which enforcement of commercial contracts and commercial dispute resolution can be improved. The commercial court system will be designed to operate according to the principles of the rule of law. Its development will require extensive regulatory and administrative support system development including mobile commercial courts as well as an appropriate legal framework, dissemination, curriculum development and training activities. In addition, Cambodia will pursue a comprehensive program of legal and judicial reform to support the rule of law in the financial sector.
- Continued public financial management reform.
- Monetary development: Increasing confidence in the domestic currency and its use. Confidence and infrastructure will be developed through progress in addressing Foundations of Finance (chapter II), Banking and Microfinance (chapter III), and Non-Bank Finance (chapter IV). On this basis, a fiscal incentive framework will be implemented, including payment of government salaries and other expenditures in riel through bank accounts and the payment system, and requiring tax and other government payments likewise to be made in riel through the payment system. As demand increases, larger denomination notes will be issued.

⁴ See chapter III.

⁵ See chapter IV.

CHAPTER III

BANKING AND MICROFINANCE

3.01 A safe, efficient and effective banking sector is absolutely essential to support financial development and economic growth in Cambodia. Unsafe banks can lead to systemic financial crisis, economic collapse and massive permanent economic losses, as in the Asian financial crises in 1997-1998. Hence, the key consideration is first to address risks: the goal is maintaining financial stability through developing an effective financial safety net, focusing on (1) financial stability, (2) banking regulation and supervision, and (3) depositor protection. Likewise, to the extent that other financial institutions such as microfinance institutions, money lenders and money changers are conducting banking business and therefore raise similar risks to banks, they should likewise be addressed. As such, this section addresses not only banks and banking but also microfinance and microfinance institutions (MFIs) as well as money lenders and money changers to the extent they are conducting banking activities.

3.02 At the same time, developing banks and banking and related institutions is important to support savings and financial resource allocation. The focus here is on providing rules and incentives to support banks and related institutions to do banking business in a safe and efficient manner, through (1) foundations of the financial system especially property rights and contract enforcement / dispute resolution mechanisms⁶, (2) preconditions to effective banking operations and supervision especially a safe and efficient payment system, and (3) effective regulation and supervision of banks and similar institutions such as MFIs, money lenders and money changers to the extent they are conducting banking business.

3.03 In most developing economies including throughout Asia, the banking sector plays the most significant role in financial resource allocation and savings in the economy. This is also the case in Cambodia and highlights the key role of the banking sector in Cambodia's economic development. At the same time, MFIs, money lenders and money changers are also active in Cambodia's financial system and play a very important role in financial resource accumulation and allocation. As such, it is important for Cambodia to have a comprehensive system to address the risks of banking activities conducted by various differing types of institution as well as to support the development of the role of these various forms of institution in supporting economic growth and poverty reduction.

3.04 In looking at the banking and microfinance sector in Cambodia, a number of key observations emerge. Amongst the banks and the banking system, there is significant liquidity but limited lending taking place. Beyond the formal banking system, related financial activities and institutions are active both formally and informally. In the formal financial system, MFIs are active lenders but face liquidity constraints. At the same time, estimates suggest that the informal financial sector is perhaps larger than the formal financial sector and active across a variety of banking related forms. In the informal financial sector there are unregistered MFIs, which may or may not view themselves as MFIs, but more often than not as development organizations, money lenders and money changers, as well as various informal financing techniques such as the tontine.

⁶ See chapter II.

3.05 In this context, the key challenges and priorities for supporting the development of banking and microfinance in Cambodia are:

- Identifying and addressing risks.
- Improving financial institution operations and increasing intermediation through human capital development, education and appropriate regulation and supervision.
- Increasing confidence through improving financial institution and supervisory functioning and education.
- Formalizing finance through increasing confidence.
- Linking banking and microfinance through increasing confidence in regulation, supervision and enforcement and developing appropriate financial infrastructure especially a national wholesale payment system, money / interbank markets including short term government securities, and improving financial information quality and transparency.
- Treating providers of similar financial services similarly to provide a level playing field and avoid regulatory arbitrage and providing a progressive, developmental system for non-banks conducting banking type activities.

A. Banking

3.06 At present, there are fifteen licensed banks, including three branches of foreign banks), four specialized banks, and two representative offices of foreign banks. In addition, there are a range of MFIs which play an important role in savings and financial intermediation for individuals and small enterprises, especially outside of the main urban areas. Further, there are a range of money lenders and money changers which play a significant role in foreign currency transmission and also small scale lending.

3.07 In relation to banking and financial stability, the NBC has been active in developing and implementing the legal framework to support banking activities, and of regulating banking and specialized financial institutions (including MFIs). These activities serve to promote macroeconomic and financial stability as well as reduce poverty.

1. Progress and Achievements since 2001

3.08 In looking forward, it is important first to take stock of what has been achieved to date.

3.09 In developing a strong banking sector, the FSDP 2001-10 highlighted six areas:

- Establishment of a basic framework for monetary policy;
- Establishment of a framework for banking supervision;
- Restructuring of the banking industry;
- Establishment of a framework for the payment system;
- Outreach to rural areas; and
- Capacity building.

3.10 In relation to the establishment of a basic framework for monetary policy, this has been discussed previously in the context of Foundations of Finance (chapter II). In relation to the establishment of a framework for banking supervision, much has been achieved: the legal

frameworks and regulatory apparatus for central banking, banking and microfinance supervision, and banking business have all been established. In these areas, key challenges lie ahead in continuing to enhance banking and microfinance supervision, and further developing the Foundations of Finance and capacity for a properly functioning banking and microfinance sector. In regard to Foundations of Finance, in relation to banking, further work is necessary in developing support for secured lending, property rights, creditor and shareholder rights, and financial information and related systems. In addition, additional effort is necessary to further expand areas of banking and related business such as leasing. Capacity building also remains key to all these aspects.

3.11 In relation to restructuring of the banking industry, likewise, much has been achieved: Significant bank restructuring took place since 2001 with the increase in minimum capital which resulted in some bank closures, with remaining banks having committed more capital and the banking sector as a whole stronger. Continued restructuring to develop a strong and effective banking sector demands further efforts, as noted above, especially in regard to the Foundations of Finance (chapter II) supporting banking business and continued capacity building, as well as transparent and effective supervision and enforcement. Further, Cambodia's accession to the WTO and related financial sector liberalization provides a key window for foreign banks to enter Cambodia's financial sector, enhancing competition.⁷

3.12 In relation to the payment system, crucial steps have been taken through the enactment of the Law on Negotiable Instruments and Payments Transactions at the end of 2005. This should play an important role in supporting the key role of financial institutions and the financial sector in enabling payments. In this area, key goals include the development of efficient and prudentially sound payment systems to reduce transactions costs, enhance confidence in the financial system and amongst financial institutions, and improve monetary policy and banking operations.

2. Objective and Approach

3.13 The overall in relation to banking is to develop a competitive, integrated and efficient banking system that is properly regulated and supervised and effectively mobilizes savings to provide financing to support economic growth and poverty reduction. Such a strong banking sector will support economic growth and poverty reduction while at the same time minimizing risks of financial crisis.

3.14 This overall objective contains two key elements: (1) financial stability, and (2) financial development to support economic growth and poverty reduction.

3.15 The importance of financial stability usually seen as assisting development and reducing the incidence of financial crisis is generally agreed, emphasizing: (1) financial regulation and supervision, and (2) improving financial institution operations and compliance.

3.16 While some causes of financial instability are beyond the influence of individual financial institutions and are best addressed through appropriate macroeconomic policies and

⁷ Liberalization and competition are discussed further in the context of chapter V, General cross-sectoral considerations.

related institutional framework⁸, if individual financial institutions are managed their own businesses in a prudentially safe and sound manner, then crises triggered by problems within any single financial institution will be minimized, thereby increasing overall financial stability. As such, financial institutions should be provided with appropriate incentives and penalties both economic and regulatory / supervisory as well as support for capacity development to encourage them to improve their own operations over time. Improvement in operations will not only decrease risks of financial crisis but also enhance the role of financial institutions in intermediation and resource allocation, thereby supporting economic growth and poverty reduction.

3.17 Financial regulation and supervision are therefore essential to protecting against financial crisis not only through the protection provided by the regulator but also through incentives and guidance given to financial institutions provided through regulation and supervision to enhance their own operations.

3.18 In relation to financial development to support economic growth and poverty reduction, the three main elements are:

- Effective means of money transmission, payment and transaction settlement.
- Savings mobilization.
- Intermediation and resource allocation.

The key to all three factors is to maintain and enhance confidence in the financial system, financial institutions and financial regulators:

- Sufficient confidence of savers so that they hold deposits domestically and place their savings within the formal financial system;
- Confidence among borrowers to use the formal financial system for financing; and
- Mutual confidence among financial institutions.

In many ways, this confidence of savers, borrowers and financial institutions results from confidence in the regulatory and supervisory system, which in turn depends on its effectiveness.

3.19 In looking to achieve banking sector stability and banking sector development, Cambodia will continue to be guided by international and regional experience and standards such as the Basel Committee on Banking Supervision's *Core Principles for Effective Banking Supervision*.

3. Preconditions for banking operations and supervision

3.20 For banking regulation and supervision to be effective in supporting financial stability and financial development, a number of preconditions must be in place. These preconditions are:

- Sound and sustainable macroeconomic policies;
- Well developed public infrastructure;
- Effective market discipline; and
- Mechanisms for providing an appropriate level of systemic protection (public safety net).

⁸ See chapter II.

3.21 Sound and sustainable macroeconomic policies is addressed in the context of Foundations of Finance (chapter II). Public infrastructure and public safety net are discussed below. Market discipline was addressed in the context of chapter I.

3.1 Well developed public infrastructure

3.22 Well developed public infrastructure includes:

- System of business laws (corporate, insolvency, contract, consumer protection, private property), consistently enforced and providing fair resolution of disputes. As discussed above, the most important priorities for Cambodia are (1) enacting laws now pending, and (2) improving enforcement and commercial dispute resolution.
- Accounting and auditing standards of international standard. As discussed above, the most important priorities for Cambodia are (1) improving human capacity in relation to financial information, and (2) developing and implementing a progressive, incentive framework for company development.⁹
- Efficient and independent judiciary, accounting, auditing and legal professions. As discussed above, the most important priority for Cambodia is improving contract enforcement and commercial dispute resolution.
- Regulation and supervision of other financial markets. These issues are addressed further in the context of chapter IV and chapter V.
- Secure and efficient payment and clearing system. In the context of Banking and Microfinance, the development of a secure and efficient payment and clearing system is a **key objective** and an **urgent priority** for Cambodia.

3.2 Payment system: Key objective and urgent priority

3.23 At present, Cambodia has no national wholesale electronic payment system. Rather, payments are made through cash deliveries or via a limited (though increasing) number of US dollar and Cambodian riel cheques. Importantly, however, in 2005 Cambodia enacted its first Law on Negotiable Instruments and Payment Transactions which provides a legal basis for negotiable instruments such as cheques, bills of exchange, promissory notes, and regulation of payment systems.

3.24 Cambodia's current lack of an efficient, secure, national payment and clearing system poses a major impediment to financial development: payments are insecure and difficult to make in large volume; money / interbank markets cannot function effectively; and macroeconomic policy instruments are severely limited. These factors suggest that developing such a system would remove a number of serious impediments to financial development in Cambodia.

3.25 In looking forward, the objective is to develop a payment system and settlement system in Cambodia that is:

- National in scope;
- Secure and safe in the context of the international experience and standards such as the Committee on Payment and Settlement Systems' *Core Principles for Systemically Important Payment Systems*; and
- Electronic.

⁹ See chapter II and chapter IV.

In addition, such a payment system will cover at least the riel. A US dollar system will also be considered.

3.26 In terms of elements, the national payment system will comprise:

- Cheque clearing and settlement;
- Wholesale interbank payments;
- Money / interbank securities transactions; and
- Support for retail payments.

3.3 Public financial safety net

3.27 Banking supervision is one element of an effective public financial safety net. In essence, the financial safety net is the overall system for supporting financial stability in the banking system. As such it includes a number of elements, of which banking regulation and supervision is the most important:

- Lender of last resort;
- Regulation and supervision;
- Systems for addressing problem bank resolution and insolvency; and
- Depositor protection.

3.28 The first element, the lender of last resort function, is designed to provide emergency liquidity to solvent banks facing bank runs. Due to Cambodia's dollarized economy, it is not possible to have a lender of last resort in the true sense. As a result, this function can only be developed if at some point in time the riel increases in use sufficiently to make up a significant portion of banking assets (for example, loans) and liabilities (primarily deposits). As such, the NBC should not provide financial support to financial institutions under the present monetary circumstances. Any such support is actually a form of subsidy or government bailout and will only be undertaken with RGC approval.

3.29 The second element, banking regulation and supervision, is discussed in detail below.

3.30 The third element, a system for problem bank resolution and insolvency, deserves attention in Cambodia before any future bank failure takes place. At the least, there is a need for a contingency plan for dealing with any future bank problems or failure. Likewise, this should be extended to considerations of bank insolvency. Cambodia will look to international guidance and experience such as the *Legal, Institutional, and Regulatory Framework to Deal with Insolvent Banks* in developing an appropriate system to address problem bank resolution and insolvency.

3.31 The fourth element, depositor protection, is addressed most importantly by the preceding three elements, especially banking regulation and supervision. It also may include structures such as (1) preferences for depositors in the context of insolvency; and (2) deposit insurance. Depositor protection beyond banking regulation and supervision, possibly including deposit insurance, may be considered in Cambodia in the medium term to longer term. At present, there is no consensus on whether or not Cambodia should adopt deposit insurance, but this is an issue for further consideration in future.

4. Banking regulation and supervision

3.32 Banking regulation and supervision needs to address a number of aspects.

4.1 Objectives, independence, powers, transparency and cooperation

3.33 The banking supervisor should have clear objectives, independence and powers sufficient to achieve those objectives in the context of transparency and cooperation with other relevant agencies and authorities. Overall, the fundamental legal framework is in place to support these elements in Cambodia. At the same time, there remains a need for continual focus on improving operational independence, transparency, governance, resources and accountability. Likewise, in the medium term, Cambodia will undertake a comprehensive review of its legal framework for banking to address inconsistencies and gaps.

4.2 Banking Activities

3.34 The framework for banking regulation should address a wide range of banking activities, including:

- Permissible activities of banks,
- Licensing criteria,
- Transfers of significant ownership,
- Major acquisitions,
- Capital adequacy,
- Risk management processes,
- Credit risk,
- Problem assets, provisions and reserves,
- Large exposure limits,
- Exposures to related parties,
- Country and transfer risks,
- Market risks,
- Liquidity risk,
- Operational risk,
- Interest rate risk,
- Internal controls and audit,
- Abuse of financial services, and
- Accounting and disclosure.

3.35 Cambodia has dealt with many of these through regulations but some gaps remain which will be addressed in the near term most importantly in relation to money laundering and abuse of financial services. Beyond this, the key focus will be upon implementation, especially in the context of improving banks' own internal processes and control systems. The focus will be on improving consistency and quality of NBC monitoring and enforcement, including through development of appropriate supervisory processes and systems.

4.3 Supervisors

3.36 The banking supervisor should have appropriate powers and systems relating to: supervisory approach, supervisory techniques, supervisory reporting, corrective and remedial powers, consolidated supervision, and home-host relationships.

3.37 The NBC has been working hard to improve supervision, but much work remains to be done. Key objectives include:

- Improvement of on-site and off-site supervision techniques.
- Continued capacity building at NBC and in banks.
- Development of NBC processes and technological systems.
- NBC and judicial implementation and enforcement.

5. Priorities for 2006-15: Banking

3.38 In looking forward, the key objectives are to:

- Develop systems to deal with problem bank resolution and insolvency;
- Develop an effective, efficient and safe national payment and settlement system; and
- Continuing to improve both the legal and regulatory framework for banking supervision and banking supervision itself, both with the overall objective of supporting financial stability and banking sector development to improve economic growth and reduce poverty.

5.1 Immediate priorities

3.39 The immediate priorities are:

- Continuing improvement of supervision, capacity building at NBC and banks, and customer education and awareness activities.
- Automating cheque clearing and settlement;
- Development of national wholesale electronic payment system, including support for interbank market, initially with banks and specialized banks as participants;
- Bringing money lenders and changers into the formal regulatory framework, initially through registration and filing requirements;
- Comprehensive development of NBC IT / MIS systems to support functions; and
- Strengthening NBC and judicial implementation / enforcement.

5.2 Intermediate and medium term priorities

3.40 The intermediate priorities are:

- Expanding payment system access to licensed MFIs;
- Providing collateralization of payment system exposures through short term government securities;
- Continued capacity building at NBC and banks;
- Customer education and awareness activities;
- Continuing improvement of supervision;
- Moving the inter-bank credit information system into the private sector, including establishing the necessary supporting legal and regulatory framework to support its functioning; and
- Supporting development of new financial products / activities in the context of equal treatment of providers and financial stability. This will include regulating money lenders and changers to the extent they are conducting banking business.

5.3 Longer term objectives

3.41 The longer term objectives which will commence on completion of the Immediate and Intermediate and Medium Term Priorities are:

- Comprehensive review of banking law and regulations to update / improve as necessary.
- Review of depositor protection system.

B. Microfinance

3.42 The FSDP 2001-10 identified rural finance as a critical sector requiring development and support. It was recognized that the banking system has not been able to address the demand for finance, from the poor, to smoothen consumption, build assets and develop micro-enterprises. This has been expressed by the most obvious manifestations of poverty, such as insufficient household income, lack of productive assets and inaccessibility of affordable financial services.

3.43 Since 2001, the microfinance sector has developed impressively: this significant success is largely the result of an overall market-based approach to development and light government intervention. Today, there are now 16 licensed MFIs, with good market performance, and an increasing number of registered MFIs. In addition, some MFIs have graduated from MFI status to bank status (as banks or specialized banks). MFIs today are involved in both credit provision and limited deposit taking.

1. Progress and achievements since 2001

3.44 In developing microfinance, the FSDP 2001-2010 highlighted five areas, using a phased approach:

- Implementing and enhancing rural credit policy;
- Strengthening supervision and regulation;
- Building financial infrastructure for microfinance;
- Creating institutional capacity; and
- Ensuring pro-poor orientation.

3.45 Overall, responsibilities have been divided between MEF, NBC and the CMA, with MEF supporting policy development and funding coordination, NBC responsible for regulation and supervision, and CMA and the industry responsible for operational aspects.

3.46 Much has been achieved in relation to the Phase I activities. The Phase II activities are taking place, although at differing paces and with highly variable achievements. The anticipated activities for Phase III have not yet started, and were not due to start until 2008, but some have taken place already, thus demonstrating the dynamism of the sector.

1.1 Implementing and enhancing Rural Credit Policy:

3.47 The RGC has formed the Credit Committee for Rural Development (CCRD). Under this framework, the MEF plays a crucial role in preparing the policy framework and

strategies relating to microfinance, in cooperation with NBC, the private sector and other concerned parties, while the NBC is responsible for regulation and supervision. The Rural Credit Policy is still under preparation, but, given the changes which have taken place in the sector over the intervening years, with international best practices being freely adopted by MFIs, MFIs (through the CMA) and the CCRD are now working closely together to develop appropriate policies, within the boundaries set by international best practices.

3.48 In looking forward, microfinance in Cambodia has developed beyond consideration only of credit, and has moved into areas such as savings, insurance and other financial services for the future. Any sets of policies developed should be enabling policies for development, and the establishment of implementation policies should rest at the level of the MFIs themselves. Their governing bodies should adopt policies on the basis of market needs. There is a growing body of international best practices in microfinance, and the role of support bodies should be to disseminate such policies and encourage their adoption or adaptation to the Cambodian situation.

3.49 Reviewing and coordinating policy continues now, and is a long-term feature of sectoral development.

1.2 Strengthening supervision and regulation:

3.50 Whilst the roles of the various bodies in supervision and regulation have been recognized, there is still considerable work to do in delineating roles and pursuing effective supervision and regulation. Cambodia has demonstrated restraint in intervening in the sector, which has directly allowed the sector to develop so well. It will therefore be as important to delineate areas in which government should not intervene, to maintain the freedom for the market to develop, as it will be to delineate and effect roles for supervision and regulation, to protect the vulnerable from exploitation.

3.51 Prudential regulations exist to protect the interests of all participants in the sector. Certainly, they provide a framework within which the microfinance sector can operate. The regulations exist in order to enable compliance with the law, and at the enterprise level, the regulations provide a framework within which by-laws and other operating methods can be framed and applied. In order that such regulations do not suffocate development, it is essential that the roles of government bodies be designed to ensure a lightness of touch in their application. Improving the application of prudential regulations is still required.

3.52 In addition, there is an urgent need to agree upon common reporting requirements, based upon prudent operations. Once common reporting systems are agreed, common performance standards will have been agreed, and these can be used as the basis for meaningful ratings, performance analyses and supervision.

1.3 Building financial infrastructure for microfinance:

3.53 This is a very important, broad, but inclusive set of activities, and will be a continuing set of activities, in the future, which will be open-ended, as the sector responds to continuously-changing market realities.

3.54 The FSDP 2001-10's recommendations to establish a range of service providers assumed that the need for such services as leasing, venture capital funds and equity funds

would arise, along with the development of the sector. However, this has not proven to be the case, and the products which the microfinance sector is developing are less sophisticated, but are still trying to meet the demands of a considerable market. In product terms, the microfinance sector is still trying to expand horizontally, to cover the needs of the market, before expanding vertically. Any products which are introduced should be demand-led, rather than being introduced as part of a desire to create new markets. There is also the need for additional service providers, as outlined below, such as specialized training and audit providers.

3.55 It is a priority to support development of links between the commercial banking sector and the microfinance sector. As was outlined in the FSDP 2001-10, the microfinance sector requires constant injections of liquidity to expand its activities, sustainably, into new areas. As new products are developed, further liquidity will be required to service the markets. Only the commercial banking system has a sufficient level of liquidity to satisfy anticipated demand. The sector has created 16 licensed MFIs, and they are performing well. The development of the network between the banks and the microfinance sector will now rely upon the development of mutually advantageous products and markets. The present demand by some banks for substantive collateral from the MFIs is traditional and understandable risk mitigation. Efforts must be made to overcome this blockage to further collaboration via possible imaginative substitutes to collateral, where the risks are manageable such as guarantees, equity participation, improved risk assessment and others, which will assist in developing the linkage between banks and MFIs.

3.56 Before the development of an institutional network and legal framework for integration reaching to small farmer and community groups, there is a need to define the market and the extent of that market, with its variations, flexibilities and characteristics. This will clarify the character of the eventual, integrated structure, and so define more clearly the legal and other requirements.

1.4 Creating institutional capacity:

3.57 Many MFIs are already profitable and sustainable, and some progress has been made in this area. The support network for those MFIs, nevertheless, requires development, and their long-term sustainability will need that support. Again, this will be a continuing set of activities, in the future, which will be open-ended, as the sector responds to continuously-changing market realities.

3.58 The intensive interventions required to build capacity via training support is still a major priority. The training support is not just required for off-the-job training, but also for the development of capacity building structures within the MFIs and systems of needs identification, skills development and management succession. This will require the identification of a suitable institution which is prepared to expand into this field and to provide such support over the long term.

3.59 Updating and upgrading skills is a priority area which must be an ongoing feature of development, with institutional capabilities for training enhanced and deepened in line with the deepening of the financial system. As the boundaries of the financial system move outwards, so should skills development, through the development of institutional outreach capabilities in training provision.

1.5 Ensuring pro-poor orientation:

3.60 Once again, this will be a continuing set of activities, in the future, which will be open-ended, as the sector changes and skills and systems are developed.

3.61 As the microfinance sector has expanded and developed, so priorities have changed. For those with disabilities and those living in resource poor areas, there may be opportunities to assist through the development of local workshops, marketing networks or other business opportunities, and their sustainability must be assessed in the same way as for other potential business partners, because they are, after all, subject to the same market forces as other entrepreneurs. There should be a policy of non-exclusion of potential customers based upon personal disability or physical remoteness, and in some areas MFIs may wish to apply to government for special grant funds to assist in establishing such support mechanisms.

3.62 Similarly, there must be extra efforts made to include women within the sector, particularly those women who are heads of household. It has been consistently shown, internationally, that financial support activities targeted at women convert more readily into improved family nutrition, improved schooling and improved family health than similar support provided to men. Also, women have been shown to be more responsible in their use of financial support, and in repaying credit, than men. Poverty assessment studies could lead to more effective targeting of financial support, and more inclusion of women, based upon desired improvements in household living standards.

3.63 Research needs to be conducted on the opportunities available for introducing micro-insurance, pensions and other financial services which may be developed to provide the safety nets which existing customers of MFIs do not presently possess.

2. Developing microfinance: The next stage

3.64 At present, as a result of rapid development, it is necessary to go deeper into the structural issues surrounding the sector, and to sequence the interventions to support the development of a well-functioning microfinance sector. Interventions to develop the Microfinance Sector will be diverse, but interdependent. There are a number of major issues which need to be addressed, and which affect the development of the sector directly.

3.65 The microfinance sector, itself, has generated its own development in Cambodia since 2001, and has moved forward in many areas. Given the proven dynamism of the sector, the character of required interventions has changed, and there is a need, now, to re-identify, prioritize and re-schedule interventions, to reflect the developing needs of the sector.

3.66 Overall, the growth of the sector will be determined as much by internal performance factors as by external interventions. Also, the needs for intervention have changed considerably. Now, the type of intervention is of a more supportive nature to on-going activities. Expanding the scope, growth and outreach of activities will arise from introducing new skills, new perspectives and new ideas, as well as introducing additional funding.

3.67 To optimize the microfinance sector's development and performance, and to provide prudential supervision to protect the more vulnerable in society from being unduly exploited,

there is a requirement for imaginative and deliberate interventions which will generate growth and create the architecture to protect the interests of all involved.

3.68 It is also essential to identify those for whom the Microfinance Sector cannot offer services. The destitute, by definition, do not have assets or potential income generating activities. They therefore have no deposits, which they could make, or income by which they might repay any loans granted to them. If loans are provided, it places the destitute in a worse position than if they had not been provided with loans, since they will be placed under pressure to repay the loans and will have debts which they never had before. The destitute can only be assisted via grants or free services to pull themselves out of their destitution and eventually enter the market for microfinance services.

3.69 In this context, key issues are:

- Funding strategy for MFIs. MFIs need to continue to develop commercial funding independent from international donors or NBC. The development of the national wholesale payment system, interbank / money market and continuing improvement in financial information will serve to support the development of increasing linkages between banks and MFIs. MFIs are often exposed to foreign exchange risks if their funding comes from outside Cambodia. As the use of the riel develops, MFIs may increasingly make loans in riel and this once again highlights the role of the banking sector in intermediation and risk management.
- Deposit taking by MFIs. Funding may come through deposit taking and this highlights the importance of appropriate regulation and supervision by NBC of banking activities by MFIs. The regulatory system should be progressive and developmental with graduated standards for institutions with different activities and which provides an incentive framework to support institutional development; for example, registered MFIs to licensed MFIs to specialized banks to banks.
- Regulatory parity. Other institutions conducting microfinance business or banking business should be treated similarly from a regulatory standpoint in order to properly address risks, reduce regulatory arbitrage and provide a level playing field. Examples include money changers, money lenders, credit cooperatives and mutual savings institutions, all of which should meet similar standards if engaging in microfinance or banking business.

3. Micro-insurance

3.70 Micro-insurance is an important risk management tool for poor households, and there are numerous coping strategies, worldwide, which low-income households use to offset crises. However, the fact that the households are low income by definition places them in highly vulnerable positions. To offset this vulnerability, and to improve coping capacities by providing additional safety nets, it may be possible to develop a range of micro-insurance products to meet market needs. There are a small number of pilot projects taking place, with licensed MFIs in Cambodia, to test limited insurance prospects, but conclusions on the results and future potentialities are not yet available.

4. Priorities for 2006-15: Microfinance

3.71 The FSDS 2006-15 has revised the delineation of the sector in the FSDP 2001-10 as “Rural Finance”, to become more inclusive, and considers the sector as “Microfinance”. This

encourages the diversification of risks and growth of diverse products, as well becoming more inclusive for those in urban areas. The objective is thus a viable, pro-poor and effective microfinance system for to provide affordable financial services to enable the poor to enhance income and reduce poverty.

3.72 Since 2001, the microfinance sector has shown remarkable dynamism, with admirable results for a sector in its present stage of development. This has been due in no small part to the RGC's willingness to allow the commercialization of microfinance in the country, with a private sector approach supported, where necessary, by the Government and the donor community. The continued development of a supportive network by the Government and donors, whilst allowing the private sector freedom to act within the legal and regulatory framework, should support additional rapid growth.

3.73 Interlinkage and integration of the microfinance sector with the commercial banking sector continues as a major priority. Looking forward, the commercial banking sector is the only reliable source of extensive liquidity which can meet the demands of the microfinance sector. Furthermore, there is a trade-off for the banking sector. The more successful of the microfinance sector's clients will eventually graduate into customers for the banks.

3.74 The microfinance sector's future development should be considered on three levels: the Macro level, the Meso level and the Micro level. Furthermore, developments should not be time-bound or time-constrained, but should be prioritized and sequenced, based upon expected impacts and absorptive capacities.

3.75 **Macro level** (Government and regulatory authorities):

- Support continued development of capacities at NBC for effective regulation and supervision of the microfinance sector, while at the same time making sure that all institutions taking deposits are subject to graduated regulatory requirements and supervision based upon size and complexity of activities.
- Agreement upon common reporting standards is required to establish sound financial performance analysis and enable the support of the sector's growth, as well as to inform the public via monthly bulletins.
- Study structural risks associated with the MFIs, in terms of governance, ownership, and the small size of some MFIs and try to resolve the weaknesses.
- Identify and define microfinance markets throughout Cambodia, and this is an area in which the MEF should provide significant support. There needs to be improved statistical analysis and market definitions, geographically, sectorally, in size and in scope. There is also a requirement to define and elaborate on the scope of alternative financing sources at the local levels (moneylenders, family, friends, village banks, cooperatives, etc.). This will inform MFIs, and provide the basis for product development, for policies and, for the Government, the potential identification of incentives to promote development as well as appropriate regulation and supervision.
- Creation of capabilities to support other forms of microfinance institutions i.e. community-based, non-registered, etc. to broaden the types of needs being met, and introduce greater variety and flexibility into the system.

3.76 **Meso level** (Technical support level):

- Establish a training facility which can provide off- and on-the-job training for all levels within the microfinance sector. The training facility should include a governing council for microfinance capacity building to include the MFIs, both licensed and

registered, in order to ensure that it meets the needs of the sector. It will develop off-the-job training courses and develop increasing outreach capabilities to support the establishment of training management systems for effective on-the-job training at MFIs and beyond. This would include training of trainers; work task analysis; needs assessment; training planning, budgeting and on-the-job delivery; appraisal methodologies; management succession training; and training recording systems. The training facility would operate as an integral, responsive part of the microfinance sector, funded by sustainable pricing of services.

- Improve the provision of management information systems (MIS) for MFIs. The quality of software and systems presently varies considerably, with some MFIs unable to access integrated accounting and loan portfolio systems, whilst others have very expensive and effective systems. Minimum standards for MIS in Cambodia need to be established, particularly when improved common reporting standards are introduced. This may call for the holding of national licenses by Meso or Macro level organizations on behalf of the MFIs, in order to ensure minimum quality of support to those organizations.
- Develop a wholesale market for loan financing, operated within the private sector and linking the MFIs with the commercial banking sector. At the moment, MFIs have difficulty in accessing credit in riel. A national wholesale payment system and money / interbank market should not only link the microfinance and banking sectors, but should also provide flexibility in the currency in which loans are provided (see Non-Bank Finance, chapter IV). Additionally, linkages should be extended via measures enabling the banks to obtain experience of lending to, and working with, MFIs. This requires a less collateral-based approach to lending and the development of more cash flow/accounts analysis-based thinking. Potential for interim guarantee measures to enable such experience to be gained will be considered.
- The recent and welcome establishment and official recognition of the Cambodian Microfinance Association (CMA) provides an opportunity for improved representation in the sector. CMA may cooperate with the CCRD to develop and disseminate improved policy options, to improve dialogue, advocacy, research and information exchange. CMA's role may be formalized in future legal and regulatory reviews of the sector.
- Build a local MFI ratings capacity, based upon commercial ratings support and also linked to a credit information exchange. The information exchange should include both positive and negative information. If customers are to graduate to the commercial banking system, they will need to have established an accessible, good credit history. The CIS established for the commercial banking sector also can be extended to the microfinance sector.
- Support continued development of participating capital / equity investment from internal and foreign investors for MFIs.

3.77 **Micro level (Retail):**

- Support to strengthen retail institutions, particularly those below the level of Licensed MFIs.
- Based upon research and statistical analysis conducted at the Macro level, a need may arise to assist other forms of microfinance institutions (non-registered, community based, etc.), and to ensure that where needs are being met by such ad hoc organizations, those needs continue to be met. The greater the variety and flexibility in the system, the stronger it will be.

- Further links should be created between NGOs dealing with the destitute and MFIs. This will allow destitute people who become non-destitute, via NGO support, to ease into the microfinance sector.

CHAPTER IV

NON-BANK FINANCE

4.01 In Cambodia, non-bank finance at the moment is essentially limited to insurance. (Microfinance, money lenders, money changers and informal lending are all considered in chapter III, Banking and Microfinance, due to their banking like activities). At the same time, with the enactment of the Law on Commercial Enterprises, the Law on Corporate Accounts, their Audit and Accounting Profession, and the Law on Negotiable Instruments and Payment Transactions, certain aspects of financial markets could now begin to develop. In addition, with the enactment of the Government Securities Law, and in the near future of the Issuance and Trading of Non-Government Securities Law, the Secured Transactions Law, and the Leasing Law and establishment of the secured transactions registry and leasing activities, further non-bank financial activities are likely to develop in the near future.

A. Insurance

4.02 The private insurance sector in any country can play an important role in its economic life. Insurance companies assist businesses with their risk management. To the extent that an entrepreneur can transfer to an insurance company those risks that cannot be directly controlled, that person is then free to marshal available resources to deal with better known commercial risks. In the early stages, insurance is a cash-flow business with limited accumulation of funds. The bulk of premiums received is consumed by claims and administrative expenses. However, certain liability obligations do arise that require the establishment of reserves or provisions against payments to be made in future years. Such obligations arise with claims for disability benefits and under life insurance contracts that are, by their nature, long-term. In support of these obligations, insurance companies take on the role of institutional investors and, as such, they can become instrumental in the development of financial markets.

4.03 The process of development of the insurance sector in an emerging market economy follows a predictable path, and usually begins with the participation of the public in certain obligatory classes of insurance, such as third party liability coverage for operators of motor vehicles. This type of coverage is made mandatory in order to protect innocent victims who may suffer injury or loss as a result of an accident. The next step occurs when credit-granting institutions, such as banks, begin to insist that collateral provided in support of loans be insured. A related step requires insurance on the life and health of the borrower.

4.04 Life insurance sales usually begin when employers seek to offer their workers a package of benefits that might include a death benefit to the surviving family members upon the untimely death of a worker. A major impetus for life insurance business growth often comes when either employers or the government launch programs for providing retirement income to workers. Life insurance in such circumstances often serves as a guarantee of support in the event a worker does not live to retirement although, in some cases, it can also be used as a funding vehicle for pension benefits.

4.05 While the initial insurance products that appear relate to mandatory coverage, the insurance industry does not experience rapid growth until such time as voluntary purchases of insurance begin. Accumulation of assets under life insurance policies only assumes substantial proportions once consumers begin to appreciate its usefulness in personal financial planning, saving for retirement or for any family need, such as education of children.¹⁰ Growth in the insurance sector depends upon the availability of discretionary, disposable income and personal choice.

4.06 A number of factors contribute to consumer confidence in insurance as a service. First and foremost is a need for public understanding of the business of insurance and the services it can provide. It is also important that the business be conducted in as transparent a manner as possible. Claims filed by policyholders should be dealt with promptly by the company. Settlement of claims must always be in conformity with the terms of the policy, but must also be perceived to be fair and reasonable in the circumstances. It has often been said that the claims department of an insurance company is actually its public relations department.

4.07 Governments can contribute to the development of the insurance sector by:

- Establishing an insurance regulatory system which ensures that only soundly-financed and prudently managed insurance companies are authorized to write business.
- Implementing an effective and efficient supervisory system to ensure continual monitoring of the financial strength and market conduct of companies.
- Empowering the supervisor with all the tools and authority required to deal with situations of non-compliance, and applying those rules across the market.
- Ensuring that rules applied to the operations of insurance companies, such as rules that govern their investment powers, are not unduly restrictive. The same standards must be applied to all companies in the marketplace.
- Providing protection against systemic risks. When an insurance company is bankrupt the government should take appropriate steps to protect the interests of policy holders.
- Raising public awareness about insurance.
- Providing training to increase professionalism.
- Protecting consumers by encouraging disclosure requirements, ensuring that information given by insurance companies is accurate.

4.08 As noted above, life insurance policies are longer term contracts. Development of sound life insurance markets requires:

- Functioning financial markets offering sound investment opportunities. Lack of domestic markets can be alleviated through international investment, and in fact this should be required even with effective domestic markets in order to provide appropriate diversification).
- Fully transparent accounting systems.
- Clear policy language that is uniformly adopted along with adequate public understanding.
- Reasonable tax treatment for savings through life insurance.
- Policy terms and values supported by sound actuarial advice.

¹⁰ There is little asset accumulation in support of employee group life insurance or through the sale of term life insurance policies of short duration.

1. Progress and achievements since 2001

4.09 In the years since the adoption of the FSDP 2001-10, much progress has been made in developing the legal and regulatory framework for insurance. However the growth of the insurance industry has been modest and further action is required if it is to reach its potential.

4.10 In 2001, the only insurance company operating in the country was Cambodia National Insurance Company (CAMINCO), a state-owned monopoly. There are now two privately-owned companies writing property and casualty insurance policies in Cambodia, in addition to CAMINCO. Another private company was operating until 2004, when it encountered financial difficulties and was liquidated. CAMINCO is in the process of being privatized.

4.11 In addition, a domestic reinsurance company, Cambodia Re, has been established. While it was originally organized as a state-owned company, private sector investors have now acquired a substantial interest in this reinsurance company. Cambodia Re benefits from a statutory requirement whereby licensed companies must cede 20 percent of their premium writings to it.

4.12 In May 2006, the RGC announced that it has entered into a public-private partnership with four foreign insurance companies to form a joint venture that will review the prospects for life insurance business. The project will involve a one-year feasibility study before any sales would be considered.

4.13 Total gross written premium for the insurance market in Cambodia is of the order of US\$ 11 million. This figure represents gross direct written premium, before consideration of any reinsurance. Owing to the small size of the local market and the relatively limited capital base, much of the insurance that is placed in Cambodia must be reinsured in order to ensure that each company's net retention on any single risk is not excessive, having regard for the company's net worth.¹¹

4.14 The FSDP 2001-10 focused on the following aspects:

- Supervision and regulations;
- Compulsory insurance;
- Insurance industry organization;
- Capacity building; and
- Pension system.

1.1 Supervision and regulations:

4.15 A Law on Insurance was passed in 2000 and the necessary regulation for implementing that law was adopted in 2001. In addition, further clarification for the regulatory framework has been provided through a series of regulations issued between 2001 and 2004, dealing with such issues as licensing rules, capital (solvency) requirements, and

¹¹ Current international best practice is to ensure that retention on a single risk does not exceed 10% of the company's capital. Such a limit resembles single borrower lending limits for banks.

accounting requirements, including the computation of provisions for amounts outstanding under claims.

1.2 Compulsory insurance:

4.16 A regulation was issued making the purchase of insurance compulsory in three situations:

- Third party liability for motor vehicles owned by commercial enterprises, NGOs and other legal persons. This excludes personal vehicles;
- Liability insurance for operators of public transport, to cover passengers as well as any third party who suffers loss, damage or injury as a result of the operations of the public transport carrier; and
- Contractor's liability on building projects, to cover workmen on the site as well as persons who might find themselves at or near a construction site.

The law also requires any insurance that purports to cover risks located in Cambodia to be purchased from a company that is licensed locally. No offshore insurance is permitted.

4.17 Unfortunately, the implementation and enforcement of these compulsory insurance requirements has not been satisfactory.

1.3 Insurance industry association:

4.18 The General Insurance Association of Cambodia (GIAC) has been established and is playing a role in the development of the sector.

1.4 Capacity building:

4.19 The MEF was given responsibility as the insurance regulator and supervisor, and an Insurance Division was created within MEF.

1.5 Pension system:

4.20 In 2003, the Ministry of Social Affairs, Labor, Vocational Training, and Youth Rehabilitation developed a law on social security that was approved by Parliament. Under the law, all formal sector workers must participate in a program of social security that provides benefits to survivors in the event of premature death of a participating worker, as well as workers compensation and ultimately retirement benefits to the worker. The regulations that are necessary to implement this law have not been issued. A number of key details have yet to be specified, among them the rates of contribution to be made on behalf of workers; the determination of how the employer and the worker will share the burden of those contributions; and the formulas for benefits.

4.21 There is as yet no legal framework for voluntary personal or corporate pension plans.

2. Supporting the development of insurance in Cambodia

4.22 In principle, Cambodia's insurance market has the potential to experience significant growth. However, if the industry is to develop further and attain proportions that will enable

it to contribute in a material way to economic development, important further steps must be taken.

4.23 In the specific situation of Cambodia, the market is still quite small when measured in terms of premium income (approximately US\$11 million in annual premiums) and much further development will be required. The FSDS 2006-2015 builds upon the groundwork laid during the first five years of operation of the FSDP 2001-10. Lessons learned in the initial period, including those related to the failure of one insurance company, will assist in planning for the next ten years.

2.1 Objective and Guidance

4.24 The objective in relation to the insurance sector is an insurance sector that protects businesses and individuals from catastrophic events and a pension system that will support retirement planning, both of which can provide capital for long-term investment. In seeking to support this objective, Cambodia will be guided by international and regional experiences and standards, including the *Insurance Core Principles* of the International Association of Insurance Supervisors (IAIS). In an immature market like Cambodia's, some of the detailed criteria, such as those dealing with the purchase of derivative investment products, do not apply. Other specifics that may not be relevant for Cambodia at the present time would include formulas for risk based capital; dynamic solvency testing; and the more sophisticated techniques for matching of assets and liabilities.

2.2 Conditions for effective insurance markets and supervision

4.25 The basic conditions for effective insurance markets and supervision are:

- A policy, institutional and legal framework for financial sector supervision;
- A well developed and effective financial market infrastructure; and
- Efficient financial markets.

These are addressed in the appropriate sections of this document.

2.3 Regulatory framework for insurance

4.26 While the general framework of the regulatory system is in place, important elements of a modern supervisory system are lacking. Additional work needs to be done in areas such as:

- role and powers of the supervisor;
- measures for dealing with troubled companies; and
- corporate governance.

4.27 As it stands, the system is defined by a law and regulations. These instruments need to be broadly disseminated in such a manner so that all affected players are fully aware of their contents. The framework also will be subject to a comprehensive review and benchmarked against best international and regional standards and practices, including those reflected in the Core Principles of the IAIS.

4.28 The system for measurement of insurance company solvency requires specific attention. The measurement of capital adequacy needs to be based on sound, comprehensive rules for the evaluation of assets and liabilities together with some guidance as to the proper composition of the asset portfolio, having regard for the nature, term and yield of the

liabilities. The actual test of capital adequacy would then compare the amounts of “free” capital and surplus to some formula requirement.

4.29 Experience has indicated a pressing need for an effective system for dealing with insolvent insurance companies, including provisions relating to bankruptcy and liquidation. This system should recognize and protect the special status of policyholders as creditors of an insurance company.

4.30 In general, the present regulatory framework fails to provide the supervisory authority with all the powers and remedial tools necessary for dealing with problems that regularly arise in the process of supervision of insurance companies. The system should delineate clearly the circumstances that will attract intervention by the supervisor, indicate the nature of the intervention and outline the means by which it will be invoked.

2.4 System for supervision of insurance companies

4.31 Supervision of insurance companies is being carried out by the MEF. The process includes collection of statistics from insurance companies, desk analysis of the data submitted, and a follow-up on findings. The staff has also begun the practice of on-site inspections but has not yet established a complete set of procedures for such inspections. Members of the inspection staff would benefit from a comprehensive training program as well as appropriate MIS and IT support.

4.32 Under the present system, companies submit complete financial statements, accompanied by an auditor’s certificate, once each year. Additional statistical information is collected for interim periods. In support of the audited financial statements, companies also complete a special prescribed form that was developed by a working group of ASEAN insurance supervisors.

4.33 At present, staff members of the Insurance Division are expected to originate, draft, and promote changes in regulatory policy regarding insurance companies, even while they must continue active supervision of the licensed companies. It is worth noting that, in most jurisdictions, supervisors are expected to concentrate on the business of supervision, leaving the development of regulations and laws to a policy unit. The supervisor’s only role in the development of regulatory policy is to identify gaps and weaknesses in the regulatory framework that require attention, and to refer these to the policy-makers for follow-up. This is an issue to be considered more generally in the medium term (chapter V, General Cross-Sectoral Considerations).

2.5 Role of the RGC

4.34 Insurance industries do not develop because the government wills them to grow. The deepest development of any such financial industry arises from the actions of individuals, of entrepreneurs, and of corporations who choose to do business with local insurance companies. Entrepreneurs become aware of the advantages insurance provides them in areas such as risk management, for example. This process does not proceed unless the purchasing public is aware of the services that insurance companies can provide and acquires the confidence in the business and financial management of those companies. Governments can help this process along in a number of ways:

- Establish a sound and comprehensive policy framework for the entire financial sector. The framework should coordinate the activities of all players in the sector. Cambodia has established a financial sector working group with these objectives. The insurance industry and its supervisors should be active participants in this working group.
- Put into place an effective system of supervision that ensures that the same rules apply to all players. The market should be open and competitive.
- Ensure that the regulatory system for insurance companies is free of built-in impediments, such as investment requirements that unduly constrain the investment activities of insurance company management.
- Ensure that fiscal rules do not impose an unreasonable tax burden on the operations of insurance companies. Savings through insurance should be treated the same way as savings through a banking institution, for tax purposes.

2.6 Regional cooperation

4.35 The nature and complexity of the insurance business is such that it is both difficult and costly for a country to equip its supervisory agency with all the human and physical resources, as well as all the modern analytical tools necessary to handle any type of problem that might arise. Having regard for the current dimensions of the insurance market in Cambodia, it may make sense for Cambodia to consult with its neighboring countries and ASEAN partners to see whether sharing of supervisory resources might be possible.

3. Micro-insurance

4.36 Microfinance institutions operating in Cambodia as in other countries have determined that their clients have insurance needs, albeit on a small scale. The death or illness of a borrower, the loss of a valuable piece of property such as an animal, weather-related losses to crops – all these events can upset the financial circumstances of participants in microfinance. From the viewpoint of the credit-granting institution, it makes sense to provide a measure for insuring the ability of the borrower to repay the loan. For this reason, pilot projects of health insurance, at a micro level, have been undertaken in Cambodia and have met with success.

4.37 Another recent initiative is the mutual benefit or fraternal benefit association approach, such that some modest amount of insurance protection is provided to members of an affiliated group of individuals. The amounts of protection are small and the participants often share in the results. For example, it is common for mutual benefit society contracts to provide that members of a society can be subject to special “assessments” in the event of poor operating experience for the society. These assessments usually take the form of reductions in benefits paid.

4.38 In all countries, insurance of this type is subjected to a different standard of regulation and supervision. The less strict standards of oversight would usually involve lower capital requirements, less detailed reporting requirements, and less exhaustive inspections by supervisors. The MEF is considering measures of this nature for application in Cambodia.

4. Priorities for 2006-15: Insurance

4.39 The FSDS 2006-2015 identifies steps that should be taken to move the industry forward: those actions that appear to be required immediately; those that can be considered to be intermediate or medium-term priorities; and those of lower or longer term priority.

4.40 In reality, most of the work relating to private pensions will be left as longer term goals for purposes of this section. Pensions and national social insurance funds for civil servants are now studied to establish as soon as possible through royal decree by the Ministry of Social Affairs, Veterans, and Youth Rehabilitation and Administration Reform Council. However, developments in this area can be regarded as quite independent of the insurance sector proposals. If the necessary resources for studies and training can be found to enable the pension initiatives to proceed at an earlier date, then they should perhaps proceed. However, having regard for the scarcity of human capital generally, and of experts within the public service who have the competence and the time to deal with such issues, it would appear to be preferable to defer the pension questions until the more urgent matters are attended to.

4.1 Immediate priorities

4.41 Immediate priorities are:

- Review of entire system. A comprehensive review of the regulatory system will be conducted in light of international best practices.
- Financial reporting standards: Financial reporting standards for insurance companies to be developed; clear rules regarding the establishment of loss reserves for claims to be developed; and audit requirements for insurance companies to be clearly defined.
- Matters relating to activities of the supervisor: Capacity building for MEF staff, including comprehensive training; consideration of regional cooperation and resource sharing; increase reliance on professionals, including adopting a file-and-use approach to reporting; introduction of MIS and IT support; and obtaining membership in the IAIS.
- Privatization of CAMINCO: The privatization of this company will complete the process of developing a private insurance sector in Cambodia.
- Inter-Ministerial Collaboration: MEF personnel, or whatever group is responsible for making insurance sector policy, will participate in Inter-Ministerial committees with representatives of the Ministry of Public Works and Transport, Ministry of Land Management, Urban Planning and Construction, Ministry of Tourism and Ministry of Interior to examine ways to promote greater compliance with the rules calling for mandatory insurance of vehicles and of construction sites.
- Commencing support for the development of life insurance through feasibility studies and legal and regulatory development. A study will be undertaken to assess the potential market for life insurance business in Cambodia, including microfinance.
- Micro-insurance: Introduce a special system for regulating and supervising the activities of its microfinance institutions that seek to offer insurance protection to their members. Rules will be less restrictive than would apply to normal insurance companies, and include parameters defining the types of institutions that may offer micro-insurance products and set appropriate bounds on the scope of their operations.
- Life insurance: Develop appropriate strategy for life insurance development, including necessary elements of legal framework. Commencing support for the development of life insurance through feasibility studies and legal and regulatory

development. A study will be undertaken to assess the potential market for life insurance business in Cambodia, including microfinance. Cambodia will revise its regulatory to enable the licensing and operation of companies that sell life insurance policies.

4.2 Intermediate and medium term priorities

4.42 Intermediate and medium term priorities are:

- Life insurance: Authorize life insurance contracts as a funding vehicle for pension and retirement savings plans.
- Actuarial requirements: There are no actuaries residing in Cambodia at present and the likelihood of establishing a local professional body is remote. Until there is more activity in the life insurance and pensions area, it is unlikely that there will be sufficient work to attract actuaries to Cambodia. Actuaries supply the technical expertise necessary to evaluate long-term obligations in either insurance or pensions business. In most developing markets, necessary actuarial skills are obtained through the services of international bureaus situated in major centers. The introduction of life insurance operations will necessitate the establishment of rules.
- Training institute: At present, there is no insurance training institution. Capacity-building is required for staff of the private insurance companies, just as it is for the supervisory staff. Provided the industry demonstrates robust growth, in the medium term it will be appropriate to consider the creation of a training institute based in Cambodia. This institute could contribute to training of sales representatives as well as supervisors and office managers.
- Consumer protection and customer awareness: As insurance is a business of contracts, for such a business to be truly effective, both contracting parties should be fully informed before entering into the contract. Settlement of any claim arising under the contract should follow the terms of the contract. Any difference of opinion with respect to that settlement should be resolved through the courts or some formal alternate dispute resolution system. In order to support development, Cambodia will consider establishing a consumer affairs entity separate from supervision. Further, Government and industry, working together should adopt measures to raise public awareness of what insurance is and what services can be expected from an insurance policy. Consideration will also be given to legal and judicial training.
- Tariff requirements and uniform policy wordings: GAIC will develop and propose a schedule of minimum prices to be charged for the most common insurance products. Tariffs proposed should be supported by independent professional assessment to ensure that they will be adequate to support the claim payments that could arise under the policies. The insurance supervisor would accept the tariffs and prescribe that the rates charged by companies should not be less than those specified in the tariff schedules. Arrangements must be made for enforcement of tariffs. Uniform policy wordings could be specified such that all companies would be expected to define coverage and nature of indemnity and loss in the same terms. The use of these wordings would also have to be enforced.
- Feasibility study into the development of a private, voluntary pensions system in Cambodia: Private pension plans, organized on a voluntary basis, are institutional investors much like insurance companies. Whereas social security programs and any mandatory program for retirement savings would fall within the purview of the Ministry of Social Welfare , voluntary schemes and their supervision would be the responsibility of the MEF. Promotion of voluntary savings for retirement will be

greatly assisted if there are fiscal incentives that make it attractive for individuals (or employers) to set aside a portion of current earnings as savings for retirement. The development of pension plans as institutional investors will also serve as a catalyst for the evolution of local securities markets.

4.3 Longer-term objectives

4.43 Longer term objectives include:

- Implementing the social security law, including issuing the appropriate supporting instruments.
- Developing a regulatory system to deal with private pensions. It will be necessary to include vesting rules for employer contributions; funding requirements for guaranteed benefits; actuarial certification for defined benefit plans; investment rules that stress yield without sacrificing safety and necessary liquidity.
- Examining the advantages of including a mandatory savings plan for formal sector workers, perhaps as a part of the social security system. Such a program may not be necessary in Cambodia, given the relatively young age of the majority of the population and the fact that the extended family concept of support is still very strong. However it must be recognized that this situation could change with greater urbanization.

B. Financial Markets

4.44 Unlike the other sectors addressed, Cambodia has not yet developed financial markets.

4.45 Financial markets are markets for tradable financial instruments, such as government bills, notes and bonds, and company shares and bonds. Financial markets comprise money / interbank markets and capital markets. Markets may involve intermediaries such as securities exchanges, securities depositories, and pooled investment and pension funds. Interbank markets are markets for short term lending usually between 24 hours and twelve months in duration, often in the form of securities such as promissory notes between banks and, in more developed financial markets, certain other financial institutions. Money markets are markets for short term loans with duration of less than one year, once again often in the form of securities such as promissory notes and short term government bills and/or notes. The interbank market provides an important mechanism for interest rate setting, liquidity management and risk management by banks and other intermediaries. Money markets extend this pricing, liquidity and risk management mechanism to governments and companies. At present, there is essentially no money / interbank market in Cambodia, although with the enactment of the Law on Negotiable Instruments and Payment Transactions and the Law on Commercial Enterprises in 2005, the fundamental legal basis for a money / interbank market now exists.

4.46 By contrast, capital markets involve instruments with a duration of one year or more (capital). Capital markets include debt markets such as bonds and equity markets such as company shares, as well as in more developed markets, derivatives (instruments whose value is calculated from the value of another underlying instrument such as a share or bond). Capital markets can provide an alternative mechanism to bank lending and direct investment for longer term finance. In addition, such markets may provide investment alternatives to

bank deposits or other asset classes such as property. Further, functioning capital markets can provide important information about economic and company performance. At present, there is a very small number of bonds issued in Cambodia by government agencies and related enterprises. There are no listed companies, securities exchange or central securities depository, though the fundamental legal basis for their development now exists through the enactment of the Law on Commercial Enterprises and the Law on Corporate Accounts, their Audit and Accounting Profession.

4.47 In addition to the money / interbank markets and capital markets, other financial markets include commodities markets where contracts for purchase and sale of certain commodities such as gold or wheat can be traded. Such markets tend to be centralized in major international centers and provide important pricing, liquidity and risk management functions to businesses dealing with commodities. At present, a centralized commodities exchange does not exist in Cambodia although less formal markets have long existed for certain agricultural commodities.

4.48 Finally, advanced financial markets also encompass derivatives: financial instruments whose value is derived from some other underlying asset such as a listed company share, government security, commodity etc. Derivatives, when developed at the appropriate point in a financial system, can provide useful mechanisms for investment and risk management. At present, derivatives markets do not exist in Cambodia, but could be considered if effective money / interbank and capital markets are developed.

4.49 Financial market participants include investment funds such as mutual and pension funds, financial institutions such as banks and insurance companies, and individual and corporate investors, as well as intermediaries such as securities exchanges, securities depositories, and securities clearing and settlement systems. At present, there are no investment funds, securities exchanges, depositories or clearing and settlement systems in Cambodia, and banks, MFIs and insurance companies are not involved in Cambodian securities business.

4.50 Overall, financial markets can provide a number of benefits to a financial system, including:

- Finance;
- Information;
- Liquidity; and
- Corporate governance.

At the same time however experience around the world has shown that they are very rarely successful in sidestepping problems in the banking sector. Further, experience from around the world has shown that effective financial markets are very difficult to develop, even in developed economies.

1. Developing financial markets in Cambodia

4.51 The RGC is supporting the development of financial markets in Cambodia for three reasons:

- In the short term, to address risks arising in the financial system.
- In the intermediate term, to remove obstacles to financial development in other sectors.

- In the medium to longer term, to develop an alternative mechanism for financing and investment.

1.1 Priority I: Address risks

4.52 Clearly, the first priority in financial sector development is to address potential risks to financial stability. In this context, there are two primary concerns at present: the development of financial fraud and pyramid schemes; and the potential development of competing securities registries for public company securities.

4.53 In relation to fraud and pyramid schemes, these can have major negative consequences for financial stability and financial development through potentially significant losses of public confidence in the financial system and its regulatory and supervisory framework. Both financial fraud and pyramid schemes are developing in Cambodia and a system must be put in place to protect the public against these sorts of activities. In addition, the public should be made more aware of potential frauds and risks through public awareness activities.

4.54 In relation to securities registries, the enactment of the Law on Commercial Enterprises in 2005 is a major step forward for financial development but at the same time it brings with it certain new risks. The most significant of these lies in the framework for public companies created under the Law. At present, no new public companies are being registered. If public companies were to be allowed under present circumstances to be registered and thereby created, such public companies would pose risks to investors and public confidence, especially through the possibility of the development of competing securities registries in the context of ownership disputes. This sort of development would be very hazardous to confidence in companies and their legal basis.

1.2 Priority 2: Remove obstacles to financial development

4.55 The second priority for the RGC is to develop those aspects of financial markets the non-existence of which create obstacles to financial development generally. A number of these have been highlighted throughout, especially:

- Improving government fiscal management;
- Improving macroeconomic policy instruments;
- Developing a national wholesale payment system; and
- Developing an interbank / money market.

4.56 For these, the development of a market for government securities, especially short term government securities, can play a significant role.

1.3 Priority 3: Investing and financing mechanism

4.57 Over the medium to longer term, financial markets may provide a mechanism to support finance and investment. At the same time, it is important to develop a progressive framework for company development which can incentivize company and human capital development.

4.58 In this context, the objective is to create a progressive, developmental, incentive-based framework for company development. As discussed in the context of Foundations of Finance (chapter I), such a framework should provide a graduated system dealing with:

- Small companies;
- Other private companies;
- Public companies; and
- (if demand exists) Listed companies.

If public companies are eventually to become listed companies with their securities available to the public through a securities exchange, then it is important to begin now to support related developments.

2. Objective and international experience

4.59 The objective is to develop financial markets which appropriately address risks, remove obstacles to financial development and support risk management and financial resource accumulation and allocation.

4.60 International experience has shown it is very difficult to develop effective financial markets. This has been highlighted by work over the past forty years in the European Union, especially continental civil law countries, and over the past twenty years by experiences in Russia, central and eastern Europe, Asia, and China.

4.61 At the same time, a number of significant, positive lessons have emerged for countries seeking to develop financial markets. An effective legal framework is essential for markets to develop. The legal framework should be designed to support:

- Protection of investors;
- Ensuring markets are fair, efficient and transparent; and
- Reduction of systemic risk.

High quality financial information is absolutely essential for markets to function. Effective enforcement of financial and other information requirements, protection against fraud and market misconduct, and protection of shareholder rights are fundamental to developing confidence in financial markets sufficient for them to be useful.

4.62 In seeking to support financial market development in Cambodia, the RGC will be guided by international and regional experience and standards, including the *Objectives and Principles of Securities Regulation* of the International Organization of Securities Commissions (IOSCO) and developing ASEAN experience and standards for developing bond markets and equity markets.

3. Legal framework for financial markets

4.63 A number of areas of the legal framework must be in place for financial markets to develop:

- Company law: Cambodia enacted in the Law on Commercial Enterprises in 2005.
- Civil Code and Commercial Contract Law: These have yet to be enacted though this is expected to occur in the near future. In addition, the Agency Law will soon be enacted.

- Taxation: Taxation has been improved but require further simplification and clarification in the context of public financial management reform to not impede financial market development.
- Insolvency Law: An insolvency law is expected to be enacted soon.
- Competition Law: This is presently in progress.
- Banking Law: Related issues are discussed in Banking and Microfinance (chapter III).
- Dispute resolution system: As discussed above, this remains a concern in Cambodia although commercial arbitration and provincial dispute resolution mechanisms may provide means to address some issues until commercial courts can be established.

4. Priorities for 2006-15: Financial Markets

4.64 As discussed above, the first priority is to address risks such as fraud and pyramid schemes as well as establish a central securities depository for all public company securities. The second priority is to remove obstacles to financial sector development, focusing on the development of a national wholesale payment system and of the money / interbank market including short term government securities. The third priority is to support the development of effective investing and financing mechanisms, focusing on the establishment of a progressive, developmental, incentive-based system for companies.

4.1 Money / interbank market

4.65 The fundamental legal framework for the money / interbank market now exists with the enactment of the Law on Negotiable Instruments and Payment Transactions. At the same time, the money / interbank markets are unlikely to develop without a safe and efficient wholesale payment system and increasing confidence amongst financial institutions which will only develop as regulation and supervision improve. Beyond these immediate needs, money / interbank market development could be supported through the development of predictable issuance of short term government securities to form the basis of a yield curve, and support liquidity and risk management; for example, as collateral in the payment system).

4.66 A Law on Government Securities was enacted on 30 November 2006. This law should provide the basis for development of short term government securities markets but will require significant measures to be taken before such securities can successfully be issued.

4.67 Money / interbank markets immediate priorities are:

- Wholesale national payment system: This is discussed in the context of Banking and Microfinance (chapter III) and also in Foundations of Finance (chapter II).
- Continued public financial management reform under the lead of the MEF.
- Electronic government securities system linked to the secured transactions registry, capital requirements for financial institutions and national wholesale payment system under the supervision of NBC. Development will begin with issuance of short term bills and notes, less than one year in duration, beginning with 30 day notes.

4.68 Money / interbank market intermediate priorities are:

- The basis for the next stage of development is completion of the immediate steps above.
- Continuing to enhance public financial management reform.

- Extending maturity range of government securities on the basis of appropriate advice and preparation.
- Considering allowing regulated financial institutions initially banks, then extending to licensed MFIs) to offer short term paper (one year or less) through the government securities system, thereby forming the basis of a true money / interbank market.

4.2 Capital Markets

4.69 The Law on Corporate Accounts, their Audit and Accounting Profession and the Law on Commercial Enterprises provide the basic framework for companies, financial information and company securities. However, they are in themselves insufficient to support capital market development.

Capital markets: Immediate priorities

- 4.70 In order to address risks (first priority), a number of steps need to be taken urgently:
- Not allowing general registration of public companies until the appropriate regulatory framework is in place, including:
 - Enactment of the Insolvency Law;
 - Agreeing the elements of the progressive company framework, including graduated requirements for small companies, other private companies, public companies and listed companies.
 - Public awareness, investor education and human resource development to support financial market development while reducing the scope for and vulnerabilities to market misconduct.
 - Money / interbank market: completion of Immediate Priorities.
 - Continuing improvement of accounting / auditing capacity.
 - Establishing a partnership with a foreign securities exchange to assist in developing domestic capital markets.

4.71 Once these elements are in place, and with the freeze on public companies registration continuing, the next step is the enactment of a Law on Non-Government Securities which provides at a minimum the following:

- Enforcement framework and an appropriate enforcement authority for financial fraud, pyramid schemes etc. in line with international standards.
- Central electronic securities depository for all public companies linked to the secured transactions registry.

4.72 In addition, there needs to be continuing improvement of accounting / auditing capacity as discussed in Foundations of Finance (chapter II).

Capital markets: Intermediate priorities

- 4.73 On the basis of the completion of the Immediate Steps:
- Implement the progressive companies framework.
 - Establish a central securities depository for all public company securities and begin general registration of public companies. This will establish the foundation of a possible public securities exchange, and will include real name registration, price

data, and both debt and equity securities of public companies, and essentially operate as an over-the-counter (OTC) public company securities market.

Capital markets: Medium term priorities

- 4.74 On the basis of the completion of the Immediate and Intermediate Steps:
- Implement the enforcement and regulatory system through an appropriate agency.
 - Continue to support the development of financial information and companies.
 - Consider establishing a formal securities exchange on the basis of the public companies securities depository, with a feasibility study as the first stage.
 - Development of appropriate licensing and regulatory scheme for securities intermediaries, including banks, insurance companies and securities firms.
 - Public offerings of securities to be permitted only through a formal securities exchange and only by public companies, including for investment funds. No public offering of securities by a company would be allowed unless it was a public company and the offering took place via a listing on the securities exchange. Private offerings will be permitted by public companies as well as by listed companies.
 - Investor compensation scheme. Once financial institutions may conduct securities business, it will be necessary to consider developing an appropriate, market based framework for investor compensation in the event of securities firm failure.

Capital markets: Longer term considerations

- 4.75 On the basis of the preceding steps, Cambodia may want to consider a number of other aspects of capital market in the longer term:
- Investment funds. At the outset, investment funds will not be permitted to establish until there exist a range of investment opportunities, including money / interbank markets and public company securities. Once these have developed, a framework for allowing the creation of investment funds will be considered, especially as it relates to pensions.
 - Pensions. In line with the suggestions in Insurance, Cambodia will consider developing a three pillar pension system, including possibly a provident fund scheme similar to those of other countries particularly in Asia.
 - Securitization. In seeking longer term financing for infrastructure and other sorts of development, Cambodia may consider developing an appropriate framework to support securitization. Such a framework may include a securitization institution such as a mortgage corporation.
 - Derivatives. As macroeconomic, monetary and fiscal frameworks improve and the use of the riel increases, Cambodia may consider allowing the development of certain types of derivatives to assist in risk management.

CHAPTER V

GENERAL CROSS-SECTORAL CONSIDERATIONS

5.01 Beyond central concerns relating to the Foundations of Finance, Banking and Microfinance, and Non-Bank Finance, as financial systems develop, additional issues arise. As a general matter, these issues must be dealt with according to the general principles outlined in chapter I and focusing on two sets of concerns: (1) financial stability and risk; and (2) financial development. Under this framework, the approach to general cross-sectoral considerations should address potential risks to financial stability as a first order concern while at the same time supporting financial development and innovation.

5.02 At this point in Cambodia's financial sector development, three considerations need to be addressed:

- Competition;
- Financial innovation; and
- Financial regulatory structure.

Other considerations will certainly arise over time as Cambodia's financial sector develops and should be dealt with in the context of the guiding principles of financial stability and financial development in the context of international and regional standards.

A. Liberalization: Foreign and Domestic Participation and Competition

5.03 Liberalization and competition bring important economic benefits in the context of supporting financial development, economic growth and poverty reduction. Research and experience suggest that a liberalized and competitive financial sector supports increased economic growth and poverty reduction. At the same time, financial sector liberalization brings with it certain risks that need to be addressed appropriately. Most importantly, financial liberalization can increase the likelihood of financial crisis if it takes place without appropriate sequencing and the development of a legal and regulatory framework to reduce risks. As such, the concerns addressed in previous chapters regarding foundations of finance, banking and microfinance, and non-bank finance are all of special significance as financial sectors are liberalized, develop and become more complex.

5.04 Unlike many developing economies, especially in Asia, Cambodia's financial sector is already largely liberalized. At the same time, it remains at an early stage of development. As a result, the key concerns in relation to liberalization and competition largely relate to issues discussed in previous chapters, that is, improving the foundations of finance, banking and microfinance, and non-bank finance.

1. International and regional liberalization commitments

5.05 In looking at liberalization, international best practice suggests that in building a competitive financial sector, countries can use international and regional arrangements to reinforce progress and encourage competition. Cambodia has done exactly this through WTO

accession and ASEAN membership. Both WTO and ASEAN membership require financial sector opening to foreign competition, and Cambodia's accession process has sought to use this process of liberalization to reinforce domestic financial sector development.

5.06 In the context of both WTO and ASEAN financial sector commitments, Cambodia has adopted a very open approach to foreign participation, and this approach is bearing fruit as it supports foreign and domestic competition to improve financial sector performance.

2. Competition law and policy

5.07 Beyond continuing to implement its WTO and ASEAN financial sector and related commitments, Cambodia also needs to consider the context of domestic competition and is presently doing so through the development of a Competition Law and related policy and institutional framework. Such framework will address the special concerns which arise in relation to the financial sector, especially those related to banking and banks. These efforts will continue and will be designed to support continued competition in the financial sector while at the same time dealing with risks as they arise in a pragmatic and market oriented manner.

3. Priorities for 2006-15: Liberalization and Competition

5.08 Immediate priorities are:

- Continued implementation of WTO and ASEAN financial sector and related commitments.
- Development of Competition Law and policy. This should take into account the special needs of the financial sector by requiring consultation with the appropriate regulatory agency in addressing competition questions in the financial sector. This is a complicated area and will require extensive effort in order to develop an appropriate law and related system.

5.09 Intermediate and medium term priorities include:

- Implementation of Competition Law and policy through an appropriate independent national institutional and enforcement framework, including cooperation and consultation with financial regulatory agencies in situations involving financial services and financial institutions. The authority will need to have sufficient capacity to investigate, analyze and deal with administrative actions relating to competition questions. This will require the development of an appropriate regulatory and administrative support system development, as well as dissemination, curriculum development and training.
- Continued participation in and support for ASEAN regional financial market development activities.

5.10 Longer term objectives include:

- Encouraging other ASEAN and WTO members to liberalize by matching Cambodia's financial sector commitments, thereby bringing benefits not only to Cambodia's financial sector but also to Asian financial development.

B. Financial Innovation

5.11 Financial innovation is integral to financial development and therefore should be supported and encouraged in the context of maintaining financial stability through appropriately addressing risks that may arise. In looking at financial systems around the world, we find two main approaches to financial innovation: permissive and restrictive. The permissive approach essentially allows financial innovation unless it is otherwise barred but always in the context of addressing risks that arise. This approach is found in the world's most developed financial systems. The restrictive approach essentially bars financial innovation unless it is specifically allowed. This approach tends to be found in less developed financial systems around the world.

5.12 In seeking to support financial development, Cambodia will adopt the permissive approach towards financial innovation, with a general policy of allowing financial innovation as long as it is not specifically barred but at the same time remaining vigilant concerning potential risks which may arise. As an example, in the context of insurance, a "file-and-use" approach will be adopted under which the MEF would not be expected to engage in any investigation of forms and rates but would rather require that any filing of new policies be supported by a report and an opinion from a qualified actuary.

5.13 Financial innovation typically takes a number of forms:

- New financial institutions;
- New financial products and services; and
- Financial institution activities and financial conglomerates.

1. New financial institutions

5.14 In the spirit of supporting domestic and foreign competition in the financial sector, new financial institutions should be allowed to establish so long as they meet appropriate requirements based on international and regional standards for licensing, authorization and operations in respect to the specific financial services which they intend to provide. For example, new banks, MFIs and insurance companies whether foreign or domestic should be allowed to establish so long as they meet the requirements for licensing, authorization and operations relating to banks, MFIs or insurance companies, as appropriate. In addition, new forms of financial institution; for example, securities firms should be allowed to establish once the appropriate legal and regulatory framework and institutional structure are in place.

2. Financial products and services

5.15 Financial product and service innovation is vital for financial market development. At the same time, new financial products and services may bring risks to financial stability which must be carefully addressed as products and services develop.

5.16 As a general matter, financial institutions should be allowed to develop new financial products and services which fall within their existing areas of business, that is, at present, banking and microfinance or insurance, so long as the financial institution concerned is otherwise already performing satisfactorily from a supervisory standpoint. Financial

institutions seeking to provide financial products and services in another sector; for example, banks selling insurance) are discussed in the following section on financial institution activities and financial conglomerates.

5.17 As new products arise, regulators and supervisors should seek to understand these products and any risks which they might present to the financial institution concerned, potential customers and the financial system as a whole. Financial institutions should have in place appropriate systems to support new products and appropriate consumer and systemic protection mechanisms should be put in place as necessary. At the same time, in some cases, development of the legal and/or regulatory framework may be necessary for some financial products or services, and financial regulators should support necessary legal and regulatory development to support financial innovation in the context of appropriately addressing risks.

5.18 As an example of the application of these general principles, Cambodia is supporting the development of leasing, both by banks and non-bank financial institutions, as appropriate. This experience provides guidance as to the approach to be adopted with other new financial products and services in future.

3. Financial institution activities and financial conglomerates

5.19 As a country's financial sector develops and its banks and other financial institutions develop in sophistication, inevitably questions will arise concerning cross-sectoral financial activities and financial conglomerates. As a general matter, countries around the world have adopted four primary structures for addressing cross-sectoral financial institution activities and financial conglomerates:

- Universal banking;
- Strict sectoral separation;
- Financial holding companies; or
- Parent / subsidiary structure.

5.20 Under the universal banking structure, financial institutions are allowed to conduct any sort of financial activity without any need for separately capitalized and/or regulated subsidiaries. Under the strict sectoral separation model, financial institutions are only allowed to undertake financial activities within the sector in which they are authorized: banks and banking, insurance, etc. Cross-sectoral activities are not permitted. Under a financial holding company model, an umbrella company – a financial holding company – may be established which in turn may own subsidiary financial institutions which undertake activities within individual financial sectors. The financial holding company is a separate company from the individual subsidiaries and does not undertake financial activities directly. Under the parent / subsidiary model, a parent financial institution; for example, a bank or an insurance company may establish separate subsidiaries to undertake financial activities in other sectors.

5.21 At this time, there is no general consensus concerning which model is the best. Likewise, there is a direct relationship between the model chosen for financial institutions and financial conglomerates and a given country's financial regulatory structure.

5.22 In addition to cross-sectoral financial activities and institution structure, a second question arises as to whether financial institutions should be permitted to undertake non-financial business. For example:

- Should banks be allowed to undertake non-financial business other than banking business? Should universal banks be allowed to undertake non-financial business as well as financial business?
- Should financial holding companies be allowed to have non-financial subsidiaries as well as financial institution subsidiaries?
- Should holding companies be allowed to own financial holding companies as well as other non-financial business?

5.23 At present, there is no general consensus regarding whether non-financial companies should be able to own financial institutions or financial holding companies. Based on its level of financial and human capacity development, Cambodia is considering to adopt an approach restricting non-financial company ownership of financial institutions or financial holding companies if established in future.

5.24 The key considerations that arise in this context are therefore a country's regulatory structure and supervisory capacity, as well as the level of sophistication within its financial sector.

4. Priorities for 2006-15: Financial Innovation

5.25 Immediate priorities include:

- Allowing establishment of new financial institutions which meet relevant licensing, authorization and operational requirements.
- Supporting the permissive approach to financial products and services in the context of addressing risks.
- Finalizing the legal and regulatory framework for leasing.
- Clarifying approach to financial institution activities, especially in the context of banks and insurance companies, and formalizing this understanding through Memoranda of Understanding (MoUs) involving the regulatory agencies involved.

5.26 Intermediate priorities include:

- Developing a permissive approach to financial product development based upon the experiences gained in the context of leasing.

5.27 Longer term goals include:

- Developing legal and regulatory framework as necessary to support financial product and service innovation; and
- Developing a clear approach to financial institution activities and financial conglomerates, supported by appropriate legal and regulatory framework or MoUs as necessary.

C. Financial Regulatory Structure

5.28 As financial product and service innovation and financial institution activities develop and increase in sophistication, countries around the world must address a second level consideration relating to the overall structure of financial regulation and supervision.

5.29 As a general matter, countries around the world have adopted four general structures of financial regulation and supervision:

- Single regulator;
- Sectoral regulation;
- Functional regulation; or
- Institutional regulation.

5.30 Once again, there is no general consensus as this time which model is best. The key issue is tailoring a country's financial regulatory structure to its own circumstances and especially its structure for addressing financial institution activities and financial conglomerates.

5.31 Cambodia has adopted essentially a sectoral regulatory system, with separate supervisory arrangements for banks and MFIs, insurance companies and securities business. This will continue to be the case though special account will be taken of risks relating to banks as their special regulatory requirements.

5.32 In addition, to regulation, countries must also consider policy setting for the financial sector. In this context, Cambodia will consider appropriate arrangements for responsibility for financial sector policy development.

5.33 Immediate priorities are:

- Clarifying permitted financial institution activities and approach, having special regard to the systemic risks posed by banks and banking activities.
- Consideration of appropriate arrangements for responsibility for financial sector policy development.
- Supporting as necessary through changes to the legal and regulatory framework or MoUs.

5.34 Intermediate and medium term priorities include:

- Comprehensively evaluating financial regulatory structure in the context of financial institution activities and financial conglomerates and domestic regulatory and supervisory capacity.
- Implementing any necessary changes to regulatory structure resulting from the comprehensive evaluation.

5.35 Longer term goals include undertaking a comprehensive review of the financial sector.

CHAPTER VI

FINANCIAL SECTOR DEVELOPMENT

MATRIX OF PRIORITIES

2006-15

The FSDP 2001-10, although operating within a timescale of ten years, does not indicate strict target timings for achievement of activities and results within the ten-year period. Rather, development arises through generic factors, involving progress in support across wide areas of intervention and policy implementation. The pace of change in each area is dependent upon the timing of interventions, the absorptive capacities and the quality of support. The interdependence, balance and mutuality of progress on issues will be of more importance than specific timings. This is why it is necessary to provide prioritized order to the sequence, rather than specified timings.

As an update and revision of the FSDP 2001-10, the FSDS 2006-15 reemphasizes the long-term development strategy (in chapter I) and enumerates priorities through a series of sector development plans. The long-term strategy is based on key lessons drawn from the experiences of financial sector development and reform in other countries, and it guides the sector development plans. Each sector development plan consists of a development vision, immediate, intermediate and medium term, and longer term reform agenda, and illustrative sequenced policy measures with lead agency responsibility. The development goal describes the sector strategy to achieve visions in each sector over a series of prioritized, sequenced steps. The reform agenda is selected to help (1) identify specific policy measures to achieve the goals that have been set, (2) sequence and pace these policy measures, and (3) clarify lead responsibility. The reform agenda, however, includes built-in flexibility because it enables policymakers to add or refine the agenda to reflect the progress made in each sector and each phase along with changing financial market conditions. This is inevitable because each reform agenda is interwoven, vertically and/or horizontally, with those in the other sectors. In case some actions are not implemented, the actions that would have followed them become infeasible. Policy measures under each intermediate reform agenda are *illustrative and indicative*. Thus, when implementing the sector development plan, policymakers may need to further refine policy actions.

The sector development plan addresses necessary standards, laws, and regulations as well as the preparation of necessary human resources and the institutional capacity for implementation. Because the mere establishment of laws and standards does not mean that financial sector development goals have been met, the FSDS 2006-15 also focuses on the institutional and human capacity building needed to implement measures that address financial sector weaknesses.

Per the FSDP 2001-10, the sector development strategy of the FSDS 2006-15 is a rolling plan that needs continuous updating to reflect achievements and the changing socioeconomic environment. If a development goal is accomplished earlier than planned, the policies that follow need to be adjusted accordingly.

Foundations of Financial Sector Development	Immediate Priorities (within 3 years) <u>Target: 2006-09</u>	Intermediate and Medium Term Priorities (3 to 5 years) <u>Target: 2009-12</u>	Long Term Goals (5 to 10 years) <u>Target: 2012-15</u>
<p>Vision: Appropriate legal, institutional and policy foundations to promote market based finance and support good governance and the rule of law.</p>			
<p>Preconditions for Financial Development and Economic Growth:</p> <ul style="list-style-type: none"> • Effective governance • Property rights and their protection • Enforcement of contracts and resolution of commercial disputes • Human capital development 	<p>Completing land and real property registration, focusing on areas which are or are likely to experience increasing numbers of transactions (major urban areas). (Lead agency: MLMUC)</p> <p>Establishing a key legal and regulatory framework for property valuation and real estate transaction services. (Lead agency: MEF)</p> <p>Strengthen the capacity building for valuers, appraisers, and real estate regulator (Lead agency: MEF/MLMUC)</p> <p>Implementation and enforcement of Cambodia's commercial legal framework, including enactment of the Commercial Contract Law,</p>	<p>Completing the land and real property registration process: significant on-going priority. (Lead agency: MLMUC)</p> <p>Developing appropriate systems relating to real estate valuation and business and strengthening a legal and regulation enforcement. (Lead agency: MEF)</p> <p>Establishing a training institute for valuers, appraisers, and real estate participants. (Lead agency: MEF)</p> <p>Implementation and enforcement of Cambodia's commercial legal framework, continued support for development of commercial arbitration, and implementation of the Commercial Contract Law and commercial court system, including appropriate supporting</p>	<p>Completing the land and real property registration process. (Lead agency: MLMUC)</p> <p>Reviewing and upgrading as necessary legal and regulatory framework for real estate markets to international standards, as well as continuing capacity building. (Lead agency: MEF)</p>

	<p>implementation through appropriate regulations and administrative systems, dissemination, curriculum development and training activities. (Lead agency: MoC / MoJ)</p> <p>Development of the commercial arbitration system, through appropriate regulations and administrative systems (including a commercial arbitration center), dissemination, curriculum development and training activities. (Lead agency: MoC)</p> <p>Support for development of local dispute resolution techniques at the provincial and other levels will be explored. (Lead agency: MoC / MoJ)</p> <p>Human capital development. This is an immediate and on-going need extending across 2006-15. Priorities include continued government staff development, public education program development, support for private sector training initiatives (including those of KICPAA, ABC, CMA and GAIC), and continued support of curriculum development for universities and other education and training institutes. (Lead agency:</p>	<p>regulations and administrative systems, dissemination, curriculum development and training. (Lead agency: MoC / MoJ)</p> <p>Comprehensive legal and judicial reform process. (Lead agency: MoC / MoJ)</p>	
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<p>Institutional Underpinnings of Finance:</p> <ul style="list-style-type: none"> • Secured transactions and leasing • Company law • Sustainable fiscal and taxation system • Macroeconomic and monetary policy and related institutional framework • Rule of law 	<p>NBC / MEF / MoC)</p> <p>Continuing to support the rule of law in the financial sector through:</p> <ul style="list-style-type: none"> • public consultation relating to all draft laws and regulations relating to the financial sector, and • public availability of all laws and regulations relating to the financial sector through the internet. <p>(Lead agency: NBC / MEF / MoC)</p> <p>Enactment of pending commercial laws / codes and development of related regulations and administrative systems, dissemination, curriculum development and training, including for the Secured Transactions Law, Leasing Law, Law on Commercial Contracts, Agency Law and Franchise Law. (Lead agency: NBC/ MoC)</p> <p>Developing and implementing a progressive company framework, including graduated requirements for small companies, other private companies, public companies and listed companies. (See Financial Markets). (Lead agency: MEF / MoC)</p>	<p>Implementation and enforcement of commercial laws / codes, related regulations and administrative systems, dissemination, curriculum development and training, including for the Secured Transactions Law, Leasing Law, Law on Commercial Contracts, Agency Law and Franchise Law, and establishment of Commercial Law and Document Center. (Lead agency: MoC / MoJ)</p> <p>Development of rule of law system in commercial context through developing a commercial court system and comprehensive legal and judicial reform process. (Lead agency: MoC / MoJ)</p> <p>Implementing progressive company framework. (Lead agency: MEF / MoC)</p> <p>Continued Public Financial Management Reform. (Lead agency: MEF)</p> <p>Monetary development: Increasing confidence in the domestic currency and its use, focusing on public financial management reform, national wholesale payment system development, and money / interbank market development including short term government securities. (Lead agency: NBC / MEF)</p>	<p>Implementing rule of law system in commercial context through commercial court system and continued comprehensive legal and judicial reform process. (Lead agency: MoC / MoJ)</p> <p>Depending on demand, issuance of larger denomination riel notes. (Lead agency: NBC)</p> <p>Continuing comprehensive legal and judicial reform process. (Lead agency: MoC / MoJ)</p>
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	<p>Improving monetary policy instruments and develop market based monetary policy framework (including the payment system – see Banking and Microfinance) and money / interbank markets including short term government securities (see Financial Markets). (Lead agency: NBC)</p> <p>Establish key legal and regulatory framework for real estate transactions, and build capacity of real estate market authority (including private sector involvement). (Lead agency: MEF)</p>	<p>Implement a fiscal incentive framework, including payment of government salaries and other expenditures in riel through bank accounts and the payment system, and requiring tax and other government payments likewise to be made in riel through the payment system. (Lead agency: MEF / NBC)</p> <p>Strengthen real estate market enforcement and capacity development, including establishment of appropriate training mechanisms. (Lead agency: MEF)</p>	
<p>Financial Market Infrastructure:</p> <ul style="list-style-type: none"> • Insolvency • Financial information • Corporate governance • Corruption and market integrity 	<p>Enactment of Insolvency Law and development of related regulations and administrative systems, as well as dissemination, curriculum development and training activities. (Lead agency: MoC)</p> <p>Continued development of financial information infrastructure, including accounting, auditing, related administrative systems and organizations (NAC, KICPAA), and human capacity development. (Lead agency: MEF)</p>	<p>Implementation and enforcement of pending commercial laws / codes. (Lead agency: MoC)</p> <p>Moving responsibility for the interbank credit information system to the private sector. (Lead agency: NBC)</p>	

	<p>Launch of inter-bank credit information system. (Lead agency: NBC)</p> <p>Completion and implementation of anti-money laundering framework and development of appropriate regulation for financial crime (see Financial Markets). (Lead agency: NBC / MEF/ MOJ/ MOI)</p>		
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Banking and Microfinance	Immediate Priorities (within 3 years) <u>Target: 2006-09</u>	Intermediate and Medium Term Priorities (3 to 5 years) <u>Target: 2009-12</u>	Long Term Goals (5 to 10 years) <u>Target: 2012-15</u>
<p>Banking Vision: A competitive, integrated and efficient banking system that is properly regulated and supervised and effectively mobilizes savings to provide financing to support economic growth and poverty reduction.</p>			
	<p>Continuing improvement of supervision, capacity building at NBC and banks, and customer education and awareness activities. (Lead agency: NBC)</p> <p>Automating cheque clearing and settlement. (Lead agency: NBC)</p> <p>Development of national wholesale electronic payment system (including support for interbank market), initially with banks and specialized banks as participants. (Lead agency: NBC)</p>	<p>Expanding payment system and credit information system access to licensed MFIs. (Lead agency: NBC)</p> <p>Providing collateralization of payment system exposures through short term government securities. (Lead agency: NBC)</p> <p>Continued capacity building at NBC and banks. (Lead agency: NBC)</p> <p>Customer education and awareness activities. (Lead agency: NBC)</p>	<p>To commence on completion of the Immediate and Intermediate Objectives are:</p> <p>Comprehensive review of banking law and regulations to update / improve as necessary. (Lead agency: NBC)</p> <p>Implementation of changes resulting from comprehensive review of banking law and regulations. (Lead agency: NBC)</p> <p>Review of depositor protection</p>

	<p>Bringing money lenders and changers into the formal regulatory framework, initially through registration and filing requirements. (Lead agency: NBC)</p> <p>Comprehensive development of NBC IT / MIS systems to support functions. (Lead agency: NBC)</p> <p>Strengthening NBC and judicial implementation / enforcement. (Lead agency: NBC / MoJ)</p>	<p>Continuing improvement of supervision. (Lead agency: NBC)</p> <p>Supporting development of new financial products / activities in the context of equal treatment of providers and financial stability. (Lead agency: NBC / MEF)</p> <p>This will include regulating money lenders and changers to the extent they are conducting banking business. (Lead agency: NBC)</p>	<p>system. (Lead agency: NBC)</p>
<p>Microfinance</p> <p>Vision: A viable, pro-poor and effective microfinance system that will provide affordable financial services to enable the poor to enhance income and reduce poverty.</p>			
	<p>Framework for microfinance:</p> <ul style="list-style-type: none"> • MFIs and CMA – operations • NBC – regulation and supervision • MEF – policy development <p>Improved MFI common reporting</p>	<p>Development of Microfinance Training facilities to cope with off the job training and capacity building support within MFIs. (Lead agency: NBC)</p> <p>Development of MFI Credit Information System and access for licensed MFIs to</p>	<p>Creation of support network for retail MFIs, below level of licensed MFIs, for provision of intermittent technical assistance. (Lead agency: MEF)</p> <p>Develop microfinance ratings companies, locally, which can, over</p>

	<p>standards for sound financial performance analysis and information provision. (Lead agency: NBC)</p> <p>Development of improved NBC supervision visit methodologies for assessing and rating MFIs. (Lead agency: NBC)</p> <p>Review of existing framework for unregistered / informal financial institutions. (Lead agency: NBC)</p> <p>Improvement in MIS in MFIs (short studies followed by development program). (Lead agency: NBC)</p> <p>Short studies to prepare groundwork for further, programmed development. (Lead agency: MEF)</p> <p>Creation of capabilities to support other forms of microfinance institutions (i.e. community-based, non-registered, etc.) to broaden the types of needs being met, and introduce greater variety and flexibility into the system. (Lead agency: NBC/ MEF)</p>	<p>banking system CIS. (Lead agency: NBC)</p> <p>Introduction of ratings capabilities in Cambodia to undertake MFI ratings regularly. (Lead agency: NBC)</p> <p>CMA to cooperate with CCRD to develop and disseminate improved policy options, to improve dialogue, advocacy, research and information exchange. (Lead agency: MEF/ CCRD/ CMA)</p> <p>Development of a private sector wholesale market for loan financing for MFIs, linked to the commercial banking sector. (Lead agency: NBC / MEF)</p> <p>Create links between microfinance market participants and organizations dealing with the destitute, to develop programs and methodologies for destitute people to graduate into the microfinance market and become non-destitute. (Lead agency: MEF)</p>	<p>the long term, assist MFIs in policy and operations improvement. (Lead agency: NBC)</p>
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Non-Bank Finance	Immediate Priorities (within 3 years) <u>Target: 2006-09</u>	Intermediate and Medium Term Priorities (3 to 5 years) <u>Target: 2009-12</u>	Long Term Goals (5 to 10 years) <u>Target: 2012-15</u>
Insurance Vision: An insurance sector that protects businesses and individuals from catastrophic events and a pension system that will support retirement planning, both of which can provide capital for long-term investment.			
	Comprehensive Review of entire regulatory system in light of international standards and best practices, including: <ul style="list-style-type: none"> • Solvency requirements • Controls over investments • Reinsurance requirements: retention limits; accounting for receivables from reinsurance companies • Accounting standards approved for insurance companies in Cambodia • Powers of supervisor and 	Life Insurance: <ul style="list-style-type: none"> • Authorize life insurance contracts as a funding vehicle for pension and retirement savings plans. (Lead agency: MEF) Actuarial Requirements: The introduction of life insurance operations will necessitate the establishment of actuarial rules mandating that each company appoint an actuary qualified through one of the recognized international organizations. (Lead agency: MEF)	Implement social security law and related regulations. (Lead agency: Ministry of Social Affairs, Veteran, and Youth Rehabilitation / MEF) Develop a regulatory system to deal with private pensions, including: <ul style="list-style-type: none"> • vesting rules for employer contribution; • funding requirements for guaranteed benefits; • actuarial certification for defined benefit plans; • investment rules that stress

	<p>remedial tools</p> <ul style="list-style-type: none"> • Brokers and agents. Clarify and simplify rules for licensing of intermediaries. • A clear path for exit from the marketplace, whether exit is voluntary or forced • Regulations concerning bankruptcy and liquidation of insurance companies under the Insolvency Law. • Clear and transparent policy-making process. • Revise regulatory framework so as to enable the licensing the licensing and operation of companies that sell life insurance policies. (Lead agency : MEF) • Reporting transparency, especially statistics. <p>(Lead agency: MEF)</p> <p>Structural changes:</p> <ul style="list-style-type: none"> • Creation of policy unit with sole responsibility for developing regulatory / supervisory policy relating to the insurance sector, shared with other financial sector supervisors. <p>(Lead agency: MEF)</p>	<p>Training Institute: Consider the creation of a training institute based in Cambodia to contribute to training of sales representatives as well as supervisors and office managers. (Lead agency: MEF)</p> <p>Consumer Protection and Public Awareness:</p> <ul style="list-style-type: none"> • Consumer affairs: establish a facility to which consumers can direct any complaints or inquiries regarding their insurance contracts. • Government and industry, working together adopt measures to raise public awareness of what insurance is and what services can be expected from an insurance policy • Claims service: Supervisors monitor claims handling practices as part of any inspection. • Training for the legal community. <p>(Lead agency: MEF)</p> <p>Tariff Requirements and Uniform Policy Wordings:</p>	<p>yield without sacrificing safety and necessary liquidity. (Lead agency: Ministry of Social Affairs, Veteran, and Youth Rehabilitation/ MEF)</p> <p>Examine the advantages of including a mandatory savings plan for formal sector workers, perhaps as a part of the social security system. (Lead agency: Ministry of Social Affairs, Veteran and Youth Rehabilitation/ MEF)</p>
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	<p>Financial reporting standards:</p> <ul style="list-style-type: none"> • Review of financial reporting standards for insurance companies and comprehensive standards developed and promulgated: “standards required of insurance companies in Cambodia”. • Establish clear rules regarding the establishment of loss reserves for claims. • Define audit requirements in respect of insurance companies. <p>Matters relating to activities of the supervisor:</p> <ul style="list-style-type: none"> • Capacity building: comprehensive program of training for personnel engaged in supervision of insurance companies. • Consideration of outsourcing of certain supervisory functions, especially in the regional context. • Increase reliance on professionals: Inspectors should not duplicate the work 	<ul style="list-style-type: none"> • Trade association to develop and propose a schedule of minimum prices to be charged for the most common insurance products • Tariffs proposed should be supported by independent professional assessment to ensure that they will be adequate to support the claim payments that could arise under the policies. • The Insurance Supervisor would accept the tariffs and prescribe that the rates charged by companies should not be less than those specified in the tariff schedules. • Arrangements must be made for enforcement of tariffs. <p>Feasibility study into the development of a private, voluntary pensions system in Cambodia and Promotion of voluntary savings for retirement through fiscal incentives. (Lead agency: MEF)</p>	
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	<p>of auditors.</p> <ul style="list-style-type: none"> • Discontinue policy form approvals and adopt a file-and-use approach. • Develop procedures manuals to guide the work of supervisory staff. • Introduce computer support to supervisory work. • Membership in the International Association of Insurance Supervisors (IAIS). <p>(Lead agency: MEF)</p> <p>Completion of privatization of CAMINCO. (Lead agency: MEF)</p> <p>Inter-Ministerial Collaboration. Inter-Ministerial committee with representatives of the Ministry of Public Works and Transport, Ministry of Land Management and Urban Planning, Ministry of Tourism and Ministry of Interior to promote greater compliance with the rules calling for mandatory insurance of vehicles and of construction sites. (Lead agency: MEF)</p> <p>Life Insurance: Feasibility study to assess the potential market for life insurance business in Cambodia and</p>		
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	<p>support for legal and regulatory development to support development of life insurance in Cambodia. (Lead agency: MEF)</p> <p>Micro-insurance. Introduce a special system for regulating and supervising micro-insurance activities and institutions. (Lead agency: MEF)</p>		
<p>Financial Markets</p> <p>Vision: Financial markets which appropriately address risks, remove obstacles to financial development and support risk management and financial resource accumulation and allocation.</p>			
	<p>Money / Interbank Markets:</p> <ul style="list-style-type: none"> • Wholesale national payment system (see Banking and Microfinance and Foundations of Finance). (Lead agency: NBC) • Continued Public Financial Management Reform. (Lead agency: MEF) • Electronic government 	<p>Money / Interbank Markets:</p> <ul style="list-style-type: none"> • Continue to enhance Government / NBC fiscal management through Public Financial Management Reform and related activities. (Lead agency: MEF) • Extend maturity range of government securities on the basis of appropriate advice and preparation. (Lead agency: MEF / 	<p>Money / Interbank Markets:</p> <ul style="list-style-type: none"> • Continue to enhance Government / NBC fiscal management through Public Financial Management Reform and related activities. (Lead agency: MEF) • Extend maturity range of government securities on the basis of appropriate advice

	<p>securities system (linked to the Secured Transactions Registry, capital requirements, payment system) under the supervision of NBC. Issuance to begin with short term bills and notes (less than one year in duration, preferably begin with 30 day notes). (Lead agency: NBC / MEF)</p>	<p>NBC)</p> <ul style="list-style-type: none"> • Consider allowing regulated financial institutions (initially banks, then extending to licensed MFIs) to offer short term paper (one year or less) through government system. (Lead agency: NBC) 	<p>and preparation. (Lead agency: MEF / NBC)</p>
	<p>Capital Markets:</p> <ul style="list-style-type: none"> • Enact Insolvency Law. (Lead agency: MoC) • Development of progressive company framework with graduated requirements for small companies, other private companies, public companies, and listed companies prior to permitting general registration of public companies. (Lead agency: MEF / MoC) • Investor education and human resource development. (Lead agency: MEF) • Develop partnership with foreign securities exchanges and regulatory organizations. (Lead agency: MEF) 	<p>Capital Markets</p> <ul style="list-style-type: none"> • Implement progressive, graduated framework for companies addressing small companies, other private companies, public companies and listed companies. (Lead agency: MEF / MoC) • Securities depository for all public companies, including real name registration, price data, and both debt and equity securities of public companies. (Lead agency: MEF / MoC) • Implementation of financial enforcement and regulation. (Lead agency: MEF) • Continuing development of financial information and company regulation. (Lead agency: MEF / MoC) 	<p>Capital Markets: Consider development of:</p> <ul style="list-style-type: none"> • Investment funds • Pensions / Provident fund scheme • Securitization framework / institution • Derivatives <p>(Lead agency: MEF)</p>

	<ul style="list-style-type: none"> • Money / interbank market – Complete Immediate Steps. (Lead agency: NBC / MEF) <p>Enactment of Law on Non-Government Securities which provides at a minimum the following:</p> <ul style="list-style-type: none"> • Enforcement framework / authority for fraud etc. • Central electronic securities depository for all public company securities (linked to Secured Transactions registry). <p>(Lead agency: MEF)</p> <p>Continuing improvement of accounting / auditing capacity. (Lead agency: NBC/ MEF)</p>	<ul style="list-style-type: none"> • Preparation for securities exchange, including feasibility study, technological development, restricting public offerings of securities only through exchange (including funds), appropriate securities intermediaries (including banks, insurance companies and securities firms) and consideration of investor compensation scheme. (Lead agency: NBC/ MEF) 	
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General and Cross-Sectoral Issues	Immediate Priorities (within 3 years) <u>Target: 2006-09</u>	Intermediate and Medium Term Priorities (3 to 5 years) <u>Target: 2009-12</u>	Long Term Goals (5 to 10 years) <u>Target: 2012-15</u>
<p>Vision: Openness to financial product and institution innovation that creates more balanced financial structure, increases the depth of the financial sector, and promotes competition in the context of financial stability.</p>			
<p>Liberalization and Competition</p>	<p>Implementation of WTO and ASEAN financial sector and related commitments. (Lead agency: MEF/ NBC / MoC)</p> <p>Development of Competition Law and policy, taking into account the special needs of the financial sector. (Lead agency: MoC / MoJ)</p>	<p>Implementation of Competition Law and policy through appropriate institutional and enforcement framework. (Lead agency: MoC)</p> <p>Participation in ASEAN regional financial market development activities. (Lead agency: MEF / NBC)</p> <p>Enactment and implementation of competition law and policy, including appropriate independent authority to investigate, analyze and take administrative action, dissemination, curriculum development and training activities. (Lead agency: MoC)</p>	<p>Encourage other ASEAN and WTO members to liberalize by matching Cambodia's financial sector commitments. (Lead agency: MEF / NBC / MoC)</p> <p>Continued development of competition law and policy system. (Lead agency: MoC)</p>

<p>Financial Innovation</p>	<p>Allow establishment of new financial institutions which meet relevant licensing, authorization and operational requirements. (Lead agency: NBC / MEF)</p> <p>Support permissive approach to financial products and services in the context of addressing risks. (Lead agency: NBC / MEF/ MoJ)</p> <p>Finalize legal and regulatory framework for leasing. (Lead agency: NBC / MEF / MoC)</p> <p>Clarify approach to financial institution activities, especially in the context of banks and insurance companies and formalize through an MoU. (Lead agency: NBC / MEF)</p>	<p>Develop a permissive approach to financial product development based upon the experiences gained in the context of leasing. (Lead agency: NBC / MEF / MoJ)</p> <p>Develop clear approach to financial institution activities and financial conglomerates, supported by appropriate legal and regulatory framework or MoU(s) as necessary. (Lead agency: NBC / MEF)</p>	<p>Develop legal and regulatory framework as necessary to support financial product and service innovation. (Lead agency: NBC / MEF / MoC / MoJ)</p>
<p>Regulatory Structure</p>	<p>Clarify permitted financial institution activities and approach, having special regard to the systemic risks posed by banks and banking activities. (Lead agency: NBC / MEF)</p> <p>Support as necessary through changes to the legal and regulatory framework or MoUs. (Lead agency: NBC / MEF)</p>	<p>Comprehensively evaluate financial regulatory structure in the context of financial institution activities and financial conglomerates and domestic regulatory and supervisory capacity. (Lead agency: NBC / MEF)</p> <p>Implement necessary changes to regulatory structure resulting from the comprehensive evaluation. (Lead agency: NBC / MEF)</p>	<p>Comprehensive review of financial system in the context of international and regional experience and standards. (Lead agency: NBC / MEF)</p>

ANNEX I

COMMITTEE ON ECONOMIC AND FINANCIAL POLICY STEERING COMMITTEE AND TECHNICAL WORKING GROUP FOR FINANCIAL SECTOR DEVELOPMENT OF THE ROYAL GOVERNMENT OF CAMBODIA

COMMITTEE ON ECONOMIC AND FINANCIAL POLICY

(Participants at the inter-ministerial like meeting on 7 December 2006 in preparation for the plenary session of the Council of Ministers)

1. H.E. Keat Chhon	Senior Minister, Minister of Economy and Finance	Chair
2. H.E. Chea Chanto	Governor, National Bank of Cambodia	Vice-chair
3. H.E. Hing Thoraxy	Representative, Office of the Council of Ministers	Member
4. H.E. Chan Tong Iv	Representative, MAFF	Member
5. H.E. Nhek Chroeng	Representative, MIME	Member
6. H.E. Ou Orhat	Representative, MOP	Member
7. H.E. Chan Monor	Representative, MOJ	Member
8. H.E. Nem Thote	Representative, MOSAVY	Member
9. Mr. Kaing Soheat	Representative, MOC	Member
10. Mr. Suon Sophal	Representative, CDC	Member
11. (Absent)	Representative, MOT	Member

RGC Steering Committee for Financial Sector Development

1. H.E Chea Chanto,	Governor of NBC	Chair
2. H.E Chea Peng Cheang,	Secretary of State, MEF	Vice-chair
3. H.E Sum Sannisith,	Secretary General, MEF	Secretary
4. H.E Nim Thot,	Secretary of State, MOSAVY	Member
5. H.E Hang Chuon Naron,	Secretary General, MEF	Member
6. H.E Sok Chenda,	Secretary General, CDC	Member
7. H.E Tal Nay Im,	Director General, NBC	Member
8. H.E Sous Sambath,	DG, General Administration, MLVT	Member
9. Mr. Pich Rithy,	Deputy DG of Technical Affairs, MOC	Member
10. Mr. Khoun Ranin,	Deputy DG of Admin and Finance, MOSAVY	Member
11. Mr. Tong Peav,	Director of Admin. & General Affairs, MOJ	Member

RGC Technical Working Group for Financial Sector Development

1. H.E. Hang Chuon Naron, Secretary General, MEF	Chair
2. H.E. Tal Nay Im, Director General, NBC	Vice-chair
3. Mr. Phan Ho, Deputy Director, NBC	Member
4. Mr. Mey Vann, Director of FID/MEF	Member
5. Mr. Minh Bankosal, First Deputy Director of FID/MEF	Member
6. Mr. Chan Sothy, Director of DIC/MEF	Member
7. Mr. On Sophanara, Director of Legal and Investment Law Dept/CDC	Member
8. Mr. Seang Sokhundy, Director of Finance & Supplies Dept., MOSAVY	Member
9. Mrs. Nguon Sokha, Director of Economic Research Dept., NBC	Member
10. Mr. Bou Chanphirou, Deputy Director of FID, MEF	Member
11. Mr. Kaing Socheat, Deputy Director of Accounting Dept., MOC	Member
12. Mr. Un Buntha, Deputy Director of Domestic Trade Dept., MOC	Member
13. Mr. Por Lai, Deputy Director of Finance & Supplies Dept., MOSAVY	Member
14. Mr. Yim Sam Ol, Deputy Director of Finance, MLTV	Member
15. Mr. Sok Sarun, Deputy Director of Admin. & General Affair Dept., MOJ	Member
16. Mr. Nong Piseth, Head of Finance Market Division, FID/MEF	Member
17. Mr. Chhay Ratanak, Head of Insurance Division, FID/MEF	Member
18. Mr. Men Sopheap, Chief of Equipment & Supplies Bureau, MOJ	Member
19. Mr. Ses Sothy, Chief of Business Management and Competition Bureau, MOC	Member
20. Mr. Ul Nak, Chief of Multilateral Assistance Bureau, CDC	Member
21. Ms. Chhor Kim Y, Bureau Chief, MOSAVY	Member
22. Mr. Yos Sam Ol, Chief of Equipment Bureau, MLTV	Member
23. Mrs. Khoun Chhorvy Vann, Vice Bureau Chief, MOSAVY	Member
24. Mr. Sy Piseith, Vice Bureau Chief of Accounting, MOJ	Member

ANNEX II

FINANCIAL SECTOR DEVELOPMENT STRATEGY 2006-2015 INFORMAL WORKING GROUPS

Foundations of Finance

- Phan Ho, NBC
- Nguon Sokha, Statistics & Economic Research, NBC
- Em Kamnan, Banking Supervision, NBC
- Un Buntha, Foreign Trade, MoC
- Om Dararith, Legal Affairs, MoC
- Mey Vann, FID, MEF
- Ming Bankosal, FID, MEF
- Nong Piseth, FID, MEF
- Douglas Arner, ADB & University of Hong Kong

Banking

- Kim Vada, Banking Supervision, NBC
- Chea Serey, Banking Supervision, NBC
- Roth Savudh, Banking Operations, NBC
- Keam Kuntha, Banking Operations, NBC
- Srey Siyout, Exchange Management, NBC
- Saphon Sophannarun, Research, NBC
- Hong Phouma, Research, NBC
- Om Dararith, Legal Affairs, MoC
- Douglas Arner, ADB & University of Hong Kong

Microfinance

- Kim Vada, Banking Supervision, NBC
- Rath Sovannorak, Banking Supervision, NBC
- Loek Thy, Banking Supervision, NBC
- Bun Chanthly, Banking Supervision, NBC
- Sok Sopheaktra, Research, NBC
- Chou Vannak, FID, MEF
- Ou Choupkosal, FID, MEF
- Keith Reed, ADB

Insurance

- Mey Vann, FID, MEF
- Bou Chanphirou, FID, MEF
- Chhay Rattanak, FID, MEF
- Uch Sophanno, FID, MEF
- Thath Chivy, FID, MEF
- Donald McIsaac, ADB

Financial Markets

- Ming Bankosal, FID, MEF
- Kao Thach, FID, MEF
- Im Meatra, FID, MEF
- Chhoeng Chantha, FID, MEF
- Om Dararith, Legal Affairs, MoC
- Nguon Sokha, Statistics & Economic Research, NBC
- Douglas Arner, ADB & University of Hong Kong

General Cross-Sectoral Considerations

- HE Hang Chuon Naron, SNEC and MEF
- HE Tal Nay Im, NBC
- HE Mao Thora, MoC
- Douglas Arner, ADB & University of Hong Kong

ANNEX III

ADB FINANCIAL SECTOR DEVELOPMENT STRATEGY TEAM

Asian Development Bank

- João Farinha-Fernandes, Mission Leader and Project Officer for TA4677 - Small-Scale Technical Assistance (SSTA) for the Financial Sector Blueprint Update, Asian Development Bank
- Purnima Rajapakse, Senior Programs Economist, Cambodia Resident Mission, Asian Development Bank
- Vandy Hem, Economics and Financial Sector Officer, Cambodia Resident Mission, Asian Development Bank

ADB TA4677 - SSTA Team

- Douglas Arner, Team Leader / Financial Sector Specialist; and Director, Asian Institute of International Financial Law (AIIFL), University of Hong Kong
- Keith Reed, Microfinance Specialist
- Donald McIsaac, Insurance Specialist
- Kang Chandarot, Cambodia Financial Sector Specialist; and Director, Cambodia Institute of Development Study

FSDS Coordination Team

- Sambo Rumony, Deputy Chief of Section, Economic Research & Statistics Department, NBC
- Chea Vuthy, Deputy Chief of Section, Bank Supervision Department, NBC
- Som Kossom, Deputy Chief of Section, Bank Supervision Department, NBC