



Report and Recommendation of the President to the Board of Directors

Project Number: 42305-033
October 2014

Proposed Policy-Based Loan for Subprogram 3 Kingdom of Cambodia: Third Financial Sector Program

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Asian Development Bank

CURRENCY EQUIVALENTS

(as of 23 October 2014)

Currency unit	–	riel/s (KR)
KR1.00	=	\$0.000245
\$1.00	=	KR4,080

ABBREVIATIONS

ADB	–	Asian Development Bank
AML/CFT	–	anti-money laundering and combating the financing of terrorism
CAFIU	–	Cambodia Financial Intelligence Unit
CBC	–	Credit Bureau Cambodia
COM	–	Council of Ministers
CPS	–	country partnership strategy
FATF	–	Financial Action Task Force
FSAP	–	Financial Sector Assessment Program
FSDS	–	Financial Sector Development Strategy
LBFi	–	Law on Banking and Financial Institutions
MEF	–	Ministry of Economy and Finance
MFI	–	microfinance institution
MOC	–	Ministry of Commerce
MOU	–	memorandum of understanding
NAC	–	National Arbitration Center
NBC	–	National Bank of Cambodia
NSDP	–	National Strategy and Development Plan
SECC	–	Securities and Exchange Commission of Cambodia
TA	–	technical assistance
TWG	–	technical working group

NOTE

In this report, “\$” refers to US dollars.

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PROGRAM AT A GLANCE

1. Basic Data		Project Number: 42305-033	
Project Name	Third Financial Sector Program - Subprogram 3	Department /Division	SERD/SEPF
Country Borrower	Cambodia Kingdom of Cambodia	Executing Agency	National Bank of Cambodia
2. Sector	Subsector(s)	ADB Financing (\$ million)	
✓ Finance	Finance sector development		15.00
		Total	15.00
3. Strategic Agenda	Subcomponents	Climate Change Information	
Inclusive economic growth (IEG)	Pillar 1: Economic opportunities, including jobs, created and expanded	Climate Change impact on the Project	Low
4. Drivers of Change	Components	Gender Equity and Mainstreaming	
Governance and capacity development (GCD)	Institutional development	Some gender elements (SGE)	✓
Knowledge solutions (KNS)	Public financial governance Knowledge sharing activities		
5. Poverty Targeting		Location Impact	
Project directly targets poverty	No	Nation-wide	High
6. Risk Categorization:	Low		
7. Safeguard Categorization	Environment: C Involuntary Resettlement: C Indigenous Peoples: C		
8. Financing			
Modality and Sources		Amount (\$ million)	
ADB		15.00	
Sovereign SDP - Program loan: Asian Development Fund		15.00	
Cofinancing		0.00	
None		0.00	
Counterpart		0.00	
None		0.00	
Total		15.00	
9. Effective Development Cooperation			
Use of country procurement systems		Yes	
Use of country public financial management systems		Yes	

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed policy-based loan to the Kingdom of Cambodia for subprogram 3 of the Third Financial Sector Program.¹

2. The development framework for Cambodia's finance sector is based on the government's 10-year rolling Financial Sector Development Strategy (FSDS). The strategy was last updated for 2011–2020.² Reforms under the FSDS have been fully discussed with all relevant government agencies, industry associations, and development partners. The FSDS has also incorporated recommendations of the 2010 Financial Sector Assessment Program (FSAP) of the International Monetary Fund and the World Bank. The Asian Development Bank (ADB) meets regularly with all development partners in the finance sector to discuss current issues, and development partners' coordination was further strengthened during the update of the FSDS for 2011–2020. Comprising three single-tranche subprograms, the third program to support the first phase of the FSDS for 2011–2020 will be completed at the conclusion of subprogram 3, following successful completion of subprograms 1 (footnote 1) and 2.³

II. THE PROGRAM

A. Rationale

3. Cambodia has enjoyed robust economic growth and was one of the world's fastest-growing economies in the first decade of this century—its real domestic gross product grew at an annual average of 9.1% between 1998 and 2008. Indirect impacts of the global economic crisis led to a slowdown in 2009 and 2010, but the recovery has been relatively quick and stable, even overcoming the negative impact of the floods in 2011 and 2013. Economic growth has been achieved under macroeconomic stability and prudent fiscal policies. Cambodia also made significant progress in poverty reduction and became one of the top five countries in the attainment of the Millennium Development Goals. On the other hand, the country's economy has been characterized as being reliant on a narrow economic base, mostly garments and tourism in terms of foreign exchange earnings. Fiscal space is also limited due to low fiscal revenues and insufficient capacity for revenue mobilization, which remains a major constraint to meeting the development priorities of the country. While the expanding manufacturing and service sectors could make the country's economy more inclusive and resilient to external shocks, a robust market-based finance sector is needed to support the growing economy. Greater connectivity and competition within the Association of Southeast Asian Nations economic community will be another challenge for Cambodia.

4. Cambodia's finance sector is highly dollarized and fragmented. Under the dollarized economy, the central bank has only limited measures to implement its monetary policies and manage inflation. It also has limited ability to provide liquidity as "lender of last resort." The finance sector has been growing significantly, although from a small base. The banking industry still dominates the finance sector, accounting for more than 90% of assets in the sector.

¹ ADB. 2011. *Report and Recommendation of the President to the Board of Directors: Proposed Programmatic Approach, Policy-Based Loan for Subprogram 1, and Technical Assistance Grant to the Kingdom of Cambodia for the Third Financial Sector Program*. Manila (Loan 2815-CAM and TA 7934-CAM).

² ADB provided project preparatory technical assistance (TA). ADB. 2010. *Technical Assistance to the Kingdom of Cambodia for Preparing the Third Financial Sector Program Cluster*. Manila (TA 7520-CAM).

³ ADB. 2013. *Report and Recommendation of the President to the Board of Directors: Proposed Policy-Based Loan for Subprogram 2 to the Kingdom of Cambodia for the Third Financial Sector Program*. Manila (Loan 3002-CAM).

Moreover, the banking industry itself is both concentrated and fragmented between urban and rural areas. The nonbanking segment and capital markets are at an early stage of development and do not yet have significant macroeconomic impact. Cambodia is now leaving the post-conflict era and faces the dual challenge of ensuring further development of the finance sector to support sustainable economic growth while striving for monetary policy independence.

5. The FSDS for 2011–2020 is aligned with Cambodia’s updated National Strategy and Development Plan (NSDP) for 2009–2013 and its Rectangular Strategy on Growth, Employment, Equity, and Efficiency, as well as with ADB’s country partnership strategy (CPS) for Cambodia, 2011–2013.⁴ The government launched the 2009–2013 update of the NSDP in mid-2010, with the overarching objective of reducing poverty to 19.5% by 2015. The policy priorities of the NSDP update intersect closely with ADB’s Strategy 2020, especially in the core areas of infrastructure, education, and finance.⁵ The CPS for 2011–2013 has singled out the finance sector as one of five priority sectors. The finance sector assessment in the strategy also identified the lack of public confidence in the overall financial system as a key constraint to the development of Cambodia’s finance sector.

6. ADB has been the leading development partner of the finance sector in Cambodia since 1999. A comprehensive approach was required to rebuild the financial system in a devastated economy that had no finance sector. Responding to the government’s needs, the approach has been broadly based so far. After successfully rebuilding the basic foundation of the banking industry under the first and second programs,⁶ the third program has begun to support the sector’s expansion to cover the important subsectors of nonbanking services and capital markets, and to boost investors’ and beneficiaries’ confidence in the system with a stronger legal and regulatory framework, necessary infrastructure, and better quality of services, including consumer protection.

7. The third program has focused on creating an enabling environment for all sector stakeholders, including the various regulators. The scope has shifted from the establishment of regulatory frameworks to their effective implementation and oversight, and more transparency. Proper financial infrastructure is required to meet rising market needs for more efficient and diverse financial services, as is further development of the legal foundations to ensure smooth transactions in the sector. These reforms require coordination within the government and careful sequencing, including dialogue with the private sector. The third program has been facilitating closer coordination.

8. Past and ongoing efforts to build a more broad-based and resilient finance sector in Cambodia have yielded several lessons. First, as the scope of the sector expands, the need for consultation, coordination, and consensus building between government ministries and agencies, and with the private sector, increases. This will require time and strong leadership in planning and executing policy measures. Second, finance sector development should be based on a sequence of well-planned steps, where each step is supported by solid technical inputs. TA resources are essential in this regard and, given the limited availability of ADB funds, strong donor coordination is essential. The third program experienced some positive outcomes of close donor consultation, whereby completion of policy actions was made possible through timely technical inputs of other development partners. Also, some initiatives developed by ADB have

⁴ ADB. 2011. *Country Partnership Strategy: Cambodia, 2011–2013*. Manila.

⁵ ADB. 2008. *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank, 2008–2020*. Manila.

⁶ Summary of Achievements under the Financial Sector Program I and II (accessible from the list of linked documents in Appendix 2).

now been implemented by other donor agencies. Third, a long-term engagement establishes understanding and trust, which is vital for any reform program to succeed but indispensable for the finance sector, where policy actions such as those relating to interest rates or foreign exchange may involve significant externalities. Implementation of the third program benefited from the strong relationship that ADB had built with government counterparts in over a decade of engagement in the sector, and the steps taken and progress made under subprogram 3 should be viewed as the building blocks that will need to be assessed in a long-term perspective.

9. ADB will continue the policy dialogue with the government to maintain the momentum of the third program under the Post-Program Partnership Framework. Also, ADB's technical assistance (TA) for implementing subprogram 2 of the Third Financial Sector Program has been extended to June 2015 to deal with the remaining issues (footnote 1). However, for the next round of support, ADB should concentrate on its areas of comparative advantage, in consultation with other development partners and the government. A first dialogue with the government to this end has started in the process of formulating the CPS, sector assessment, and strategy and road map with consideration to relevant ADB strategies on the finance sector development.⁷

B. Impact and Outcome

10. The impact will be a sound, market-oriented finance sector that supports the mobilization of financial resources. The outcome will be a growing, resilient, and efficient financial system.⁸

C. Outputs

11. The third program comprises three single-tranche subprograms that were to be implemented from December 2010 to December 2013. Because of the delay caused by the general election in July 2013, the implementation period was extended to June 2014. In terms of policy actions,⁹ the government has requested minor modifications to 8 policy triggers and 2 policy milestones. Among modified policy actions, one policy trigger and one policy milestone have now been incorporated in programs of other development partners with additional resources to support related capacity building. The program also includes an additional policy trigger involving the introduction of the negotiable certificate deposit program to improve commercial banks' liquidity management. Subprogram 3 has 20 policy triggers and 11 policy milestones. The four policy triggers are still on-going and are expected to be completed by December 2014. Further details are provided in Appendix 4. The proposed revisions do not materially affect the program's impact, outcome, and outputs. Subprogram 3 has four outputs: (i) improved legal, regulatory, and institutional framework; (ii) improved financial infrastructure; (iii) strengthened finance sector governance; and (iv) enhanced finance sector efficiency. Key activities for each output are described in paras. 12–29.

⁷ These strategies include the following: ADB. 2011. *Financial Sector Operational Plan*, Manila, and ADB. 2012. *Microfinance Development Strategy 2000: Sector Performance and Client Welfare*. Manila.

⁸ The design and monitoring framework is in Appendix 1.

⁹ Policy actions are policy triggers for the loan (noted in bold in the policy matrix in Appendix 4). Policy milestones, while important in achieving the objectives of the program, are not policy triggers for the loan. They are presented to show the additional reforms implemented by the government.

1. Improved Legal, Regulatory, and Institutional Framework

12. Update and enhance the legal foundation for banks and microfinance institutions.

Under the Second Financial Sector Program,¹⁰ a comprehensive review of the Law on Banking and Financial Institutions (LBFI), conducted with ADB TA, raised issues relating to consumer protection, bank secrecy provisions to support the development of a credit information-sharing system, administrative procedures for insolvent or distressed banks, and protection or immunity of bank regulators. The National Bank of Cambodia (NBC) wanted to incorporate other FSAP (para. 2) inputs into the LBFI and the Law on the Organization and Conduct of the NBC during FSP III. The First Initiatives (a trust fund administered by the World Bank) provided additional support and enabled consultations on the two laws between the World Bank and government agencies. The consultation process further delayed the implementation of the required policy actions, so the NBC decided to expedite the process by covering the issues raised through regulations rather than amendments to the laws by December 2014. The NBC will continue to work on the revision of the two laws to address current and emerging issues relating supervision as stipulated in the FSDS for 2011–2020.

13. Strengthen bank supervision capacity and adopt measures to sustain financial stability.

To coordinate finance sector supervision and to prepare for the event of financial crisis, a memorandum of understanding (MOU) between the NBC, the Ministry of Economy and Finance (MEF), and the Securities Exchange Commission of Cambodia (SECC) was prepared with TA provided by the World Bank that included workshops on and simulation of a financial crisis. Following the consideration of the draft under subprogram 2, the MOU, which establishes procedures for practical information exchange and coordination between (and accountability of) domestic supervisors in a financial crisis, was signed in July 2014. It is a critical achievement given the highly dollarized economy of Cambodia. Also, NBC drafted a national strategy to promote the use of riels for inter-ministerial consultation. Further, based on the *prakas*¹¹ on internal control and corporate governance, the NBC has completed a corporate governance profile of each licensed bank to be used for onsite inspection.

14. Strengthen prudential supervision and regulations of microfinance institutions. The NBC has been working to improve the quality of supervision of microfinance institutions (MFIs) under subprograms 1 and 2. The Economist Intelligence Unit report on microfinance in 2013 ranked Cambodia fifth among 55 countries in the category of regulatory framework.¹² Under subprogram 3, the NBC completed an assessment of compliance with the Microfinance Activities and the Core Principles for Effective Banking Supervision.¹³ Eight of the 29 principles are yet to be complied with. They relate to the compatibility of the regulatory framework with the banking industry and the risk management capacity of MFIs. Further work will pave the way for quality services of MFIs and a more inclusive finance sector in Cambodia.

15. Enhance the legal foundation to support financial and commercial transactions. A strong legal foundation to support financial and commercial activities is critical for sound economic development in Cambodia. Subprogram 2 supported the upgrade of the financial legal

¹⁰ ADB. 2007. *Report and Recommendation of the President to the Board of Directors: Proposed Program Loan and Technical Assistance Grant to the Kingdom of Cambodia for the Second Financial Sector Program Cluster (Subprogram 1)*. Manila (Loan 2378-CAM and TA 4999-CAM).

¹¹ A *prakas* is an administrative order issued by government agencies.

¹² Economist Intelligence Unit. 2013. *Global microscope on the microfinance business environment – 2013*. London.

¹³ Bank for International Settlements. 2010. *Microfinance Activities and the Core Principles for Effective Banking Supervision*. Basel.

infrastructure, including the drafting of a consumer protection law and a financial trust law. Under subprogram 3, a draft consumer protection law and a draft comprehensive trust law have been submitted to the Council of Ministers (COM), and the new Law on Insurance was cleared by the COM and has been approved by the National Assembly. Initially, the trust law under subprogram 3 was intended to cover only MFIs, but after consultation with stakeholders, the government requested an expansion in scope to include broader economic activities and the supervision of leasing companies. ADB agreed and provided additional TA inputs for drafting a comprehensive trust law. The secured transaction registry, an integral part of lending activities to protect collaterals, was strengthened under the Secured Transaction Law as part of the third program's activities. Effective coordination between development partners prompted the International Finance Corporation to join efforts to support the government in further improving the registry.

16. Confidence in the finance sector improved under Output 1. These progressive steps, which help make the financial system more resilient to external shocks, were made possible by close coordination between donors and efforts to increase the leverage of policy reforms. The risk-weighted capital adequacy ratio of banks and MFIs has been maintained above 20% compared to the minimum ratio of 15%. Moreover, the trust scheme to protect the capital of MFIs, the consumer protection scheme, and the improvement to the secured transaction registry all contribute to building risk-mitigating measures and boosting confidence in the finance sector.

2. Improved Financial Infrastructure

17. Modernize the national payments, clearance, and settlement system. Continued from subprogram 1, the National Clearing System was commissioned during subprogram 2 and the NBC held consultations with the banking industry to establish the shared switch system during subprogram 3.¹⁴ The Ministry of Commerce (MOC) continued consultations with the NBC and the Ministry of Post and Telecommunications, on the drafting of the e-Commerce Law. The draft law is expected to be submitted to the COM by December 2014.

18. Enhance consumer access to credit, consumer protection, and market confidence. Continued from subprograms 1 and 2, a privately owned credit information bureau—the Credit Bureau Cambodia (CBC)—was established in 2011 as a joint venture of the Association of Banks in Cambodia, the Cambodia Microfinance Association, and an international service provider. It began operating in March 2012 during subprogram 2. The CBC's comprehensive coverage for both banking and MFIs obtained positive feedback on addressing the over-indebtedness issues. Under subprogram 3, the NBC introduced a governance structure to maintain confidentiality of data and a fee table acceptable to both the Association of Banks in Cambodia and the Cambodia Microfinance Association. While working on strengthening the institutional framework, the NBC together with industry associations also carried out financial literacy programs for the public, which attracted a majority of female participants.

19. Develop the interbank and government securities markets. Commenced under subprogram 2, MEF continued to develop market procedures for Treasury bills under subprogram 3. However, the government's debt management strategy envisages that the issuance of government bonds would not take place until 2018. In September 2013, the NBC introduced the negotiable certificate deposit program to improve banks' liquidity management; this was an additional initiative under the third program to further broaden banks' risk management options.

¹⁴ The system for sharing information on the transactions of clients including balance and payments.

20. **Develop domestic securities market.** Under subprogram 3, SECC has submitted the draft sub-decree on bankruptcy initially prepared during subprogram 2 to the COM and initiated an evaluation of the legal framework for new markets, including collective investment schemes, credit rating agency, and securities borrowing and lending. Commenced during subprogram 2, SECC also concluded a self-assessment on compliance with the core principles of the International Organization of Securities Commissions as a preparatory step for future application for membership. SECC established an in-house customer complaint center to deal with investor protection issues and, to increase its own capacity, started giving financial support to its staff for attending the chartered financial analyst program.

21. **Develop insurance industry.** ADB and MEF agreed to cancel the actuarial study on life insurance to develop a mortality table, because it was deemed premature in view of the nascent character of the life insurance business, which only started in 2012. However, the accounting guidelines for the insurance sector were developed under ADB TA during subprogram 3, creating the foundation for sound growth of this important subsector.

22. **Financial infrastructure improved under Output 2.** The growth of the banking system has further advanced the shift from risky cash-based transactions to safe and more transparent ones that require proper records. The National Clearing System is an essential infrastructure to settle an increasing number of check payments and remittances, as well as e-payments. The number of checks cleared daily has reached 3,837 in 2013 compared to 2,195 in 2010 with more electronic payments and transfers transacted. The e-Commerce Law aims to lay the legal foundation for e-payments. The CBC, with its broad database, effectively solved the issue of over-lending to a single entity. The third program has been supporting the development of the bond and capital markets. It is expected that these markets will open investment opportunities for the nonbanking industry (insurance and pension) in the medium term.

3. Strengthened Finance Sector Governance

23. **Promote international initiatives on anti-money laundering and combating the financing of terrorism.** Cambodia has gained membership in the Asia Pacific Group on Money Laundering and is committed to complying with the Financial Action Task Force (FATF) recommendations, international conventions, and United Nations Security Council resolutions. Cambodia is undergoing the FATF International Co-operation Review Group process and since July 2011 has been on the gray list of jurisdictions that have strategic deficiencies in anti-money laundering and combating the financing of terrorism (AML/CFT), but high-level political commitment to rectifying the shortcomings through an action plan has been made. Cambodia issued a sub-decree on the establishment of a national AML/CFT coordination committee in April 2012. During subprogram 2, the Cambodia Financial Intelligence Unit (CAFIU) undertook risk assessment of NBC supervised institutions. Under subprogram 3, the Prime Minister has granted approval to implement the national risk assessment recommended by FATF, and authorized CAFIU to coordinate it with all relevant ministries and agencies. CAFIU prepared a strategic implementation plan for the national risk assessment, which it submitted to the CAFIU board under subprogram 3.

24. **Enhance corporate governance and transparency in the finance sector.** Under subprogram 2, SECC started to promote the use of the code of corporate governance for listed companies and conducted an educational campaign with emphasis on responsibilities of the board of directors, corporate secretaries, and management. Under subprogram 3, the coverage was expanded to non-listed companies. NBC started to collect the gender-segregated data on a regular basis.

25. **Establish commercial dispute resolution mechanism.** Under subprogram 2, MOC had undertaken to establish the National Arbitration Center (NAC) with the joint support of ADB and International Finance Corporation. NAC's first general assembly for the election of the first board of directors was held in January 2013, and the directors, including representatives from the private sector, were duly appointed. Subprogram 3 helped the recruitment and training of new arbitrators and finalized the business plan for NAC to ensure its operational and financial sustainability. MOC cemented its commitment to NAC by granting it office space. NAC was duly operationalized at the first board of directors' meeting in July 2014.

26. **Improve accounting and auditing profession.** Although the draft Accounting and Auditing Law had been submitted to the COM under subprogram 2, it was returned to MEF because of a deficiency relating to sanctions. The draft law is expected to be resubmitted to the COM by December 2014. Financial support for a new university curriculum based on International Financial Reporting Standards and for an existing scholarship program continues to build the number of local qualified accountants.

27. **Governance and transparency strengthened under Output 3.** Good governance has been a priority throughout, and the third program in particular has supported the government's commitments to the international community. This will improve the finance sector's reputation and the international community's confidence in the country. The audited financial statements of financial institutions are publicly disclosed. The support for AML/CFT is expected to contribute to Cambodia's removal from the FATF gray list. The promotion of corporate governance and adoption of internationally recognized financial reporting standards will further assure investors. The establishment of an alternative dispute resolution mechanism outside the courts confirms Cambodia's commitment to the World Trade Organization membership.

4. Enhanced Finance Sector Efficiency

28. **Modernize the business registration system.** Based on the assessment conducted under subprogram 1, it concluded that MOC's corporate registration system needs to be consolidated and upgraded to improve the national database of corporate entities and make corporate information more accessible to stakeholders in the financial market, be it investors, lenders, or the general public. This will reduce transaction costs and improve efficiency. Under subprogram 3 and with TA from ADB, an adequate budget was provided and the consolidation process commenced. The World Bank approached MOC and agreed to continue the initiative with support from the Trade Swap Fund (a trust fund administered by the World Bank). This is expected to be a more comprehensive endeavor.

29. **Efficiency enhanced under Output 4.** The company registration system and its corporate data are a prerequisite for lenders and investors to conduct initial credit evaluations. Without provision of affordable and reliable data, the evaluation process is lengthier and costlier. Once a proper and efficient system is established, the lending rates of financial institutions reflecting reduced transaction costs will be more affordable and economy of scale in term of fees charged will come from an expanding small and medium enterprise sector.

D. Development Financing Needs

30. The third program, with its three subprograms, requires a total of \$45 million equivalent from ADB's Special Fund resources. The size of the budget support program depends on (i) the financing needs for sector development as identified during country programming and strategy formulation; (ii) the importance the government attaches to the reform program; and (iii) the

estimated costs of designing and implementing the medium-term reform program minus the estimated financial support from other development partners.¹⁵ This estimate includes costs that must be absorbed by the government to support the growing finance sector. For example, growth in quantity (number of financial institutions) and quality (need for more sophisticated supervision) requires greater government capacity in terms of well-qualified staff, proper institutional settings, and system support. The estimate also includes system development and upgrades of participating agencies and self-regulatory organizations¹⁶ to ensure a more efficient and secure financial infrastructure. For example, in addition to the regular administrative budget, MOC was allocated a specified budget of \$200,000 for system development under subprogram 3. These initiatives will further increase investor confidence and reduce the costs associated with financial transactions. These costs are modest, however, when compared with the opportunity costs to Cambodia of not further developing the finance sector. The loan for subprogram 3 will be withdrawn in a single tranche upon satisfactory completion of all subprogram policy triggers and following loan effectiveness. The proceeds of the loan will be disbursed in accordance with the provisions of ADB's Simplification of Disbursement Procedures and Related Requirements for Program Loans.¹⁷

31. The government has requested a loan in various currencies equivalent to SDR9,876,000 from ADB's Special Funds resources to help finance subprogram 3. The loan will have a 24-year term, including a grace period of 8 years, an interest rate of 1.0% per annum during the grace period and 1.5% per annum thereafter, and such other terms and conditions as set forth in the draft loan agreement. Loan proceeds will be used to finance the full foreign exchange cost of items produced and procured in ADB member countries.¹⁸ ADB will retain the right to audit the use of the loan proceeds and to verify the accuracy of withdrawal application certification. The closing date of the loan is 30 June 2015, by which date all proceeds of the loan will have been fully disbursed.

E. Implementation Arrangements

32. The NBC will be the executing agency, and MEF, MOC, and SECC will be the implementing agencies. The finance sector steering committee and the technical working group (TWG), as updated under regulation 393 of 21 June 2011, will oversee the implementation of the FSDS for 2011–2020 and coordinate with government ministries and agencies concerned. To ensure timely program implementation, the TWG—chaired by a senior MEF official and comprising senior officers from MEF, MOC, NBC, SECC, and other relevant government agencies—will meet as needed to review progress and consider pending issues. The TWG will report to the steering committee, chaired by the governor of the NBC, and will propose concrete actions to resolve any issues that arise. A senior officer of the NBC has been appointed as program director and will assist ADB in coordinating day-to-day program implementation with MEF, MOC, NBC, SECC, and other agencies. The program director will be required to submit quarterly progress reports and an annual report on the overall progress of subprogram implementation and, in particular, on progress in implementing policy actions adopted for the program. The implementation period of subprogram 3 is from December 2012 to June 2014.

¹⁵ ADB. 2011. Policy-Based Lending. *Operations Manual*. OM D4/BP. Manila (para. 32).

¹⁶ The organizations independent from the government that provide the various services to the public including the National Arbitration Center and the Credit Information Bureau supported under the Third Program.

¹⁷ ADB. 1998. *Simplification of Disbursement Procedures and Related Requirements for Program Loans*. Manila.

¹⁸ List of Ineligible Items (accessible from the list of linked documents in Appendix 2).

III. DUE DILIGENCE

A. Economic and Financial

33. The program will generate economic gains through successful implementation of medium-term policy actions. A stronger legal, regulatory, and institutional framework will improve the operational efficiency of banks and ensure proper supervision and consumer protection. An improved financial infrastructure will help broaden access to finance and other financial services. Strengthened finance sector governance will lead to better quality of financial reporting and effective AML/CFT measures. Greater finance sector efficiency will reduce information and transaction costs of commercial activities. For example, under reasonably competitive market conditions with proper supervision and a low nonperforming loan ratio, the amount of credit extended in the sector will grow, with favorable terms and conditions for borrowers, especially a lower interest rate spread. Even under conservative assumptions, the estimated benefits of the program far exceed the loan amount. The expected benefits from a reduced interest margin were estimated at \$125 million, against the total loan amount of the third program (\$45 million).¹⁹

B. Governance

34. An assessment of the country's public financial management systems was carried out to understand fiduciary risks and determine appropriate fiduciary arrangements under the third program. The assessment considered ADB's report on Cambodia's country governance risk assessment and risk management plan,²⁰ and the Public Expenditure Financial Accountability report.²¹ Although these reports highlight weaknesses in the budgeting, auditing, reporting, and internal control systems,²² the government's reform agenda under its 2004 Public Financial Management Reform Program has produced initial positive impacts. Nonetheless, ongoing measures are required to further improve the quality of financial reporting and auditing. ADB provided support to the National Audit Authority to strengthen its capacity for auditing externally funded projects. The government established CAFIU in 2010 to prevent transactions in breach of AML/CFT rules. Under subprogram 3, efforts continued to (i) promote corporate governance and financial literacy, (ii) promote the International Financial Reporting Standards in industries and academia, and (iii) strengthen the enforcement of AML/CFT regulations.

35. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government and the NBC. Consistent with its commitment to good governance, accountability, and transparency, the government will agree on certain covenants with ADB to institute, maintain, and comply with internal procedures and controls following international best practices to refrain from engaging in activities such as corruption, money laundering, or the financing of terrorism.

C. Poverty and Social

36. Subprogram 3 is categorized as a general intervention to support sustainable economic growth and is expected to contribute to poverty reduction indirectly.²³ Further, the promotion of inclusive finance facilitated by finance sector development expands the outreach of affordable

¹⁹ Summary Program Impact Assessment (accessible from the list of linked documents in Appendix 2).

²⁰ ADB. 2012. *Cambodia: Country Governance Risk Assessment and Risk Management Plan*. Manila.

²¹ Public Expenditure Financial Accountability. 2010. *Public Finance Management Assessment: Cambodia*. Washington DC.

²² Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

²³ Summary Poverty Reduction and Social Strategy (accessible from the list of linked documents in Appendix 2).

formal financial services to the poor and rural micro enterprises and so has direct impacts on poverty reduction. While finance sector reforms based on market principles have been gender neutral, the results show that improved access to financial services has brought more benefits to women in rural areas. The NBC reported that the proportion of women borrowers in MFI lending had reached 82% in 2013. In the MFI subsector, women held 70% of deposits and accounted for 30% of employees in 2013. These results show that subprogram 3 has contributed to increased gender benefits. Further study may be needed on whether women have less control over the use of loan money than men, or have limited access to long-term finance.

D. Safeguards

37. In compliance with ADB's Safeguard Policy Statement (2009), the program is classified category C for impacts on the environment, involuntary resettlement, and indigenous peoples.

E. Risks and Mitigating Measures

38. The program assumes continuing political stability and macroeconomic recovery from the global economic downturn. Major risks and mitigating measures are described in detail in the risk assessment and risk management plan (footnote 22). The main risks are external challenges to sustainable economic growth, weak governance and corruption in the sector, and weak execution and implementation of policy reforms. With the design safeguards, the integrated benefits and impacts are expected to far outweigh any costs.

IV. ASSURANCE

39. The government and the NBC have assured ADB that implementation of the program shall conform to all applicable ADB policies, including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement as described in detail in the loan agreement. No disbursement shall be made unless ADB is satisfied that the government has completed the policy actions specified in the policy matrix relating to the program.

V. RECOMMENDATION

40. I am satisfied that the proposed policy-based loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the loan in various currencies equivalent to SDR9,876,000 to the Kingdom of Cambodia for subprogram 3 of the Third Financial Sector Program, from ADB's Special Funds resources, with an interest charge at the rate of 1.0% per annum during the grace period and 1.5% per annum thereafter; for a term of 24 years, including a grace period of 8 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan agreement presented to the Board.

Takehiko Nakao
President

27 October 2014

DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets and Indicators with Baselines	Data Sources and Reporting Mechanisms	Assumptions and Risks
Impact A sound, market-oriented finance sector that supports the mobilization of financial resources	<p>Total private sector credit of banks at 35% of GDP or more by 2017 (baselines: 29% in 2010; 48% in 2013)</p> <p>Total bank deposits at 45% of GDP or more by 2017 (baselines: 35% in 2010; 49% in 2013)</p> <p>Access to credit for 15% or more of the population by 2017, of which at least 60% are women (baselines: 9% of total population in 2010, of which women account for 59%; 13.2% and 78% in 2013)</p>	<p>Annual reports, including audited financial reports of banks, insurance firms, and licensed MFIs</p> <p>Progress reports from NBC</p> <p>Key financial data from NBC</p>	Assumptions Continuing political stability Macroeconomic recovery from global economic downturn Risk Slow recovery from global financial and economic shocks
Outcome A growing, resilient, and efficient financial system	<p>Increase of broad money supply to 45% of GDP or above by 2014 (baselines: 38% in 2010; 53% in 2013)</p> <p>Solvency ratio of banks and MFIs maintained above 15% throughout the program period (baselines 15% in 2010; 25% for banks and 20% for MFIs in 2013).</p> <p>Ratio of NPLs to total loans of banks maintained below 10% (baselines: 3% in 2010; 3% in 2013)</p>	<p>National accounts, and economic reports and official statistics of the Government of Cambodia and other international development agencies</p> <p>Published audited reports of banks, MFIs, and insurance firms</p> <p>Published audited reports of banks, MFIs, and insurance firms</p>	Assumptions The government remains committed to reforms and to implementing the Financial Sector Development Strategy, 2011–2020 Complementary support from other development partners continues Risk Systemic risks in the financial system are not contained or managed in a coordinated manner
Outputs 1. Improved legal, regulatory, and institutional framework	<p>Revised law on banking and financial institutions and revised law on organization of the NBC adopted, and updated regulations to align with appropriate international standards by 2014 (in progress)</p> <p>Average interest rate spread below 10.0% by 2013 (baselines: 12.8% in 2010; 7.1% in 2013)</p> <p>Average return on assets for banks maintained above 2.0% (baselines: 1.4% in 2010, 1.9% in 2013)</p> <p>Core Basel principles adopted for effective supervision by 2013, and onsite inspection of banks undertaken once a year (substantially completed)</p>	<p>Official copy of the approved revised laws and the approved regulations</p> <p>Progress reports from NBC</p> <p>Progress reports from NBC</p> <p>NBC progress report on the implementation of core Basel principles</p>	

Design Summary	Performance Targets and Indicators with Baselines	Data Sources and Reporting Mechanisms	Assumptions and Risks
	<p>Core Basel principles implemented with suitable adjustments, as elaborated in the Basel Committee on Banking Supervision of the Bank for International Settlements Guidelines, by 2014 (substantially completed).</p> <p>Solvency ratio of all MFIs maintained above 15% annually (baselines: average capital adequacy ratio of 22% in 2010; 20% in 2013)</p> <p>Financial trust law reviewed by the COM and insurance law enacted by 2013 (completed)</p> <p>Consumer protection law reviewed by the COM by 2013 (completed)</p>	<p>Progress reports from the NBC</p> <p>Progress reports from the NBC</p> <p>Copy of the financial trust law submitted to the COM and insurance law as approved by the National Assembly</p> <p>Consumer protection law submitted to the National Assembly</p>	
2. Improved financial infrastructure	<p>Full solution phase for check clearance commissioned by 2012 (completed)</p> <p>Shared switch for electronic payment procured and installed by 2013 (in progress)</p> <p>Number of checks cleared daily reaching 2,250 or more by 2014 (baselines: 2,195 in 2010; 3,837 in 2013)</p> <p>Number of ATMs reaching 600 or more by 2013 (baselines: 501 in 2010, 766 in 2013)</p> <p>A working credit information bureau for banks and MFIs by 2013, and NPLs of MFIs kept below 3% (Credit Bureau Cambodia officially launched in March 2012 and 0.6% NPLs in 2013)</p> <p>A study of indebtedness of MFI customers, at least 50% women, completed by 2013 (completed)</p> <p>Life insurance introduced by 2012 (three life insurance firms in 2013)</p> <p>Gross insurance premium reaching \$28 million by 2013 (baselines:</p>	<p>Reports of the NBC on payment system working group with banks</p> <p>Progress report of consultants on implementation of the approved payments system road map</p> <p>Quarterly reports from the NBC on clearance and settlement developments</p> <p>Progress reports from the NBC</p> <p>Progress reports from the Credit Bureau Cambodia</p> <p>Copy of report on level of indebtedness</p> <p>Progress reports from MEF on life insurance development and insurance premiums</p>	

Design Summary	Performance Targets and Indicators with Baselines	Data Sources and Reporting Mechanisms	Assumptions and Risks
	\$24 million in 2010; \$46 million in 2013)		
3. Strengthened finance sector governance	<p>CAFIU fully compliant with Financial Action Task Force 40+9 recommendations by 2013 (in progress)</p> <p>Banks and financial institutions implementing IFRSs by 2014 (substantially completed)</p> <p>National Arbitration Center operating with qualified arbitrators by 2012 (completed)</p> <p>At least 20 locally qualified certified public accountants under the government scholarship by 2013 (baselines: 11 qualified in 2010; 30 in 2013)</p>	<p>Progress reports from CAFIU</p> <p>Annual audited financial statements of banks and financial institutions</p> <p>MOC letter confirming establishment of the National Arbitration Center and progress report from the center</p> <p>Progress reports from the National Accounting Council of MEF</p>	
4. Enhanced finance sector efficiency	Company registration systems consolidated and fully operational by 2013 (taken over by the World Bank)	Reports available from the registry to the public	
Activities with Milestones^a <ol style="list-style-type: none"> 1. Improved legal, regulatory, and institutional framework <ol style="list-style-type: none"> 1.1 NBC to issue the necessary regulations to rectify shortcomings in the Law on the Organization and Conduct of the National Bank of Cambodia and the Law on Banking and Financial Institutions (December 2014) 1.2 NBC, MEF, and SECC to sign the memorandum of understanding recommended by the 2010 Financial Sector Assessment Program (July 2014) 1.3 NBC to arrange for self-assessment of compliance with the Basel core principles on microfinance (December 2013) 1.4 MOC to submit the draft Consumer Protection Law to the COM (August 2014) 2. Improved financial infrastructure <ol style="list-style-type: none"> 2.1 MOC to submit the draft e-Commerce Law to the COM (December 2014) 2.2 NBC to make the Credit Bureau Cambodia operational by developing governance structure (December 2013) 2.3 NBC to introduce the Negotiable Certificate of Deposits (NCD) program to improve banks' liquidity management (March 2014) 2.4 SECC to submit the draft (bankruptcy) sub-decree to the COM (October 2014) 2.5 MEF to develop accounting guidelines for life insurance business (March 2014) 3. Strengthened finance sector governance <ol style="list-style-type: none"> 3.1 CAFIU board to adopt national risk assessment framework (August 2014) 3.2 SECC to promote use of code of corporate governance and conduct educational campaign (June 2014) 3.3 MOC to continue recruitment and training of new arbitrators (June 2014) 3.4 The National Accounting Council to resubmit new Accounting and Auditing Law to the COM (December 2014) 4. Enhanced finance sector efficiency <ol style="list-style-type: none"> 4.1 MOC to initiate consolidation of the company registration system (July 2014) 			Inputs \$15 million equivalent

ADB = Asian Development Bank, CAFIU = Cambodia Financial Intelligence Unit, COM = Council of Ministers, GDP = gross domestic product, MEF = Ministry of Economy and Finance, MFI = microfinance institution, MOC = Ministry of Commerce, NBC = National Bank of Cambodia, NPL = nonperforming loan, SECC = Securities and Exchange Commission of Cambodia.

^a See subprogram 3 policy actions in Appendix 4.

Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

<http://adb.org/Documents/RRPs/?id=42305-033-3>

1. Loan Agreement
2. Sector Assessment (Summary): Finance
3. Contribution to the ADB Results Framework
4. Development Coordination
5. Country Economic Indicators
6. International Monetary Fund Assessment Letter
7. Summary Poverty Reduction and Social Strategy
8. Risk Assessment and Risk Management Plan
9. List of Ineligible Items

Supplementary Documents

10. Summary Program Impact Assessment
11. Summary of Achievements under Financial Sector Program I and II

DEVELOPMENT POLICY LETTER

KINGDOM OF CAMBODIA
Nation Religion King

Ministry of Economy and Finance



National Bank of Cambodia

Phnom Penh, August 20, 2014

Mr. Takehiko Nakao
President
Asian Development Bank
Metro Manila, Philippines

**Subject: Development Policy Letter – CAMBODIA: Programmatic Approach for the
Third Financial Sector Program (FSPIII), Subprogram 3**

Dear Mr. Nakao,

On behalf of the Royal Government of Cambodia, we would like to thank the Asian Development Bank (ADB) for the substantial assistance it has provided to Cambodia for many years. ADB's assistance to support the Government's development of the financial sector is highly appreciated. This letter supplements the previous development policy letters that were attached to the Report and Recommendation of the President for the Third Financial Sector Program (FSPIII), Subprograms 1 and 2. The Subprograms 1 and 2 were approved by the ADB Board of Directors on 29 November 2011 and 14 May 2013, respectively. This supplementary letter outlines some of the achievements to-date in reforming the financial sector and reaffirms the continuous commitment of the Royal Government to the further development of the sector under Subprogram 3 and the implementation of remaining activities previously agreed to as part of the medium-term program. With changing domestic circumstances and developmental priorities, the executing and implementing policy reforms request minor modifications. The flexibility of programmatic approach allows making minor adjustments to the reform program under Subprogram 3. Therefore, this supplementary letter should be read in conjunction with the attached policy matrix which has been updated.

Progress and Achievements

An assessment of progress in implementing finance sector reforms indicates that much has been achieved in transforming Cambodia's finance sector. One such indicator is that the finance sector has expanded and deepened, with M2 to GDP rising at a rapid pace from 13% in 2001 to 53% in 2013. Likewise the overall scope and size of the banking system has also grown. The banking system has adequately provided for economic needs in the last decade and the National Bank of Cambodia (NBC) has been able to maintain monetary and financial stability. That, along with fiscal prudence has contributed substantially to

macroeconomic stability, making it possible for Cambodia to achieve unprecedented average economic growth of 9.1% between 1998 and 2008, placing Cambodia amongst the top ten developing countries in the world in terms of economic growth. This was slowed down in 2009 caused by the recent global economic crisis.

While recent severe flooding in late 2011 and the continuing global economic uncertainty have impacted our economy, growth picked up to 7.4% in 2013, primarily due to the increase in exports of garments, footwear, and milled rice as well as rising number of tourist arrivals. Inflation has also subsided.

Future Strategy and Growth

Looking ahead, the country aims to return to pre-crisis levels of economic growth. Moreover, the drivers of change in the country that are likely to influence the structure of the financial sector and the ways in which funds are intermediated within the system, as envisioned in the country's national strategic development plan and Rectangular Strategy, include among others the targeted diversification of the country's export and product base, the emphasis on the development of the rural sector, the need to develop infrastructure (as well as the repair and rehabilitation of existing infrastructure) to meet the needs of a rapidly rising population and attract much needed foreign investment, and the reduction of dependence on declining concessional financing in the future.

The overarching goal remains the reduction of poverty and as the Rectangular Strategy of the government clearly enunciates, good governance will continue to be central to the achievement of the country's goals. Moreover, the government is committed to pursuing market-oriented policies in its finance sector.

Consequently, and in moving to implement the FSDS 2011–2020, lessons of the past clearly illustrate that maintaining monetary and financial stability will be crucial to economic growth; enhancing financial intermediation by developing the domestic financial market, in view of a diversifying economy and emerging market needs, will be an important linchpin of the strategy; promoting good governance under which financial growth and development is to be pursued will anchor the strategy; and enhancing efficiency in the way the sector operates will help facilitate the implementation of the strategy.

FSP III, subprogram 3 will continue to focus on the following key reform areas to promote the development of a sound, market-oriented finance sector that supports resource mobilization and allocation, thereby contributing to sustainable economic growth and poverty reduction as originally enunciated in the Government's long-term vision for the finance sector.

Maintain Stability in the Financial Sector

We have emphasized the need to strengthen coordination among various regulatory and supervisory authorities as the financial system increases in breadth and depth and in complexity and sophistication. Several rounds of discussions have been held amongst the various regulatory agencies with the aim of reaching a common ground regarding market regulation and supervision and to avoid potential overlaps and lack of clarity in their respective roles. We are pleased to inform you that the MOU on Financial Crisis Preparedness, Prevention and Management has been duly signed among the three financial sector regulators. However, the need for coordination in an environment that is developing and volatile goes beyond institutional and local borders. Coordination is also increasingly required with the Cambodian Financial Intelligence Unit to prevent risks from money laundering and the financing of terrorism, as well as cross-border cooperation with foreign regulatory agencies that have banks operating in Cambodia.

In parallel, the framework for conducting banking supervision, as well as the capacity of banking supervisors, will continually be upgraded to ensure that processes and procedures followed, conform with the Basel Core Principles of Effective Banking Supervision and the Basel Core Principles on Effective Supervision of Microfinance Activities. Financial reporting will be enhanced to include consolidated financial reports for banks and electronic transmission of information for microfinance institutions. Both on-site as well as off-site supervision methodologies will continually be reviewed and upgraded in line with market developments and applicable global standards.

The legal foundation to support commercial transactions is being strengthened with the proposed law to protect consumers, given the low level of literacy among the population, especially in the rural areas, which will enhance transparency and disclosure in financial transactions. The National Arbitration Center has been established and operationalized in July 2014 as the important step to provide the alternative dispute resolution (ADR) measures.

The government is also supporting the development of long-term sources of financing and financing mechanisms that lend stability to local finance, as we are acutely aware that mismatches in funding have been one of the precipitating factors in the East Asian financial crisis. Consequently, a new Law on Insurance has been approved by the National Assembly and the Senate on 27 June 2014 and 21 July 2014, respectively to support the development of a life insurance market in the country. A Legal and Regulatory framework for public sector trust has been established and a comprehensive Trust Law is being prepared after wide stakeholder consultations. Impediments to the operation of leasing in the country are being addressed including the issuance of implementing regulations and facilitating leasing operations by expanding the use of the securities registry to include leasing.

Over the long-term, due to the risks posed by the heavy dollarization of the economy, the government is actively promoting the greater use of the riel.

Improve Confidence and Financial Intermediation

In order to raise market confidence and improve financial intermediation, the payments and clearance and settlement systems are being modernized and moving towards alignment with international standards. This would enhance access to dependable services that match emerging market requirements throughout the country and would also facilitate resource mobilization. The "Full Solution" phase of the payments system architecture has been commissioned to allow for the nationwide clearing of checks and electronic payment orders. With the advent of mobile phone banking and other means of electronic transfers, the e-Commerce Law that has been drafted is to be updated and promulgated.

One of the major impediments to the freer access to credit within the financial system has been the lack of reliable credit information. This has been enhanced under FSP III by operationalizing a private sector owned Credit Bureau that provides credit information to member banks and microfinance institutions and thus helps reduce market premiums for credit risk, lowers intermediation costs and improves the efficiency of financial intermediation. On microfinance, in parallel, a program to enhance financial literacy is being established and a study to determine over-indebtedness in the sector has been conducted for the benefit of various stakeholders to help further reduce the risk of lending.

The sector strategy also envisions the development of, both the money and capital markets, with the NBC initiating the establishment of an interbank market. Following this will be the issuance of government securities, to broaden and diversify the means for

intermediating funds within the financial system. In the equities market, a stock exchange was launched in July 2011 and the supporting market infrastructure is being established. The first listing involving the Phnom Penh Water Authorities took place in April 2012 and the second IPO followed in June 2014. Subsequently, a corporate bond market will be developed along with the possible establishment of a credit rating agency. The Securities and Exchange Commission of Cambodia (SECC) will ensure that the current system conforms with the IOSCO Core Principles and the Committee on Payment and Settlement Systems/IOSCO Recommendations on Securities Settlement Systems. SECC will also ensure that investors are fully informed about the risks and operation of the securities market and that market participants undergo examinations including fit and proper testing, and investors are able to access assistance when lodging complaints.

The Law on Insurance has been approved by the Senate and is now waiting for the signature of His Majesty the King of Cambodia. The Ministry of Economy and Finance (MEF) intends to promote awareness of various insurance protection products among the population and enhance the operation of life insurance products.

Promote Good Governance

It is essential that we succeed in promoting good governance in the finance sector as investor confidence is paramount. This will be achieved by (i) exercising vigilance over money laundering and the financing of terrorism, (ii) adopting a code of corporate governance for business companies to increase transparency and establish ethical standards, (iii) establishing dispute resolution mechanisms and procedures to facilitate settlement of disputes, and (iv) aligning accounting and audit systems with international standards to improve reliability of financial information and ensure fair and objective reporting.

The Royal Government has gained membership in the Asia Pacific Group on Money Laundering (APG) and is committed to complying with the Financial Action Task Force recommendations and relevant international conventions and United Nations Security Council resolutions. The financial intelligence unit (CAFIU), established in 2008, administers regulations on anti-money laundering and countering financing of terrorism. The CAFIU is committed to be compliant with the FATF 40+9 recommendations. Most of the core recommendations have been addressed and the Royal Government agreed to address the remaining strategic deficiencies. It was already authorized for the CAFIU to undertake the National Risk Assessment.

Enhance Financial Sector Efficiency

Currently, a large number of business enterprises operating in the country have remained unregistered and there is therefore a lack of business information on many of these entities. This lack of a database makes it difficult to conduct studies on these enterprises and promote their development. We plan to have business registration in the country modernized to enable the relevant authorities to monitor compliance with accounting and audit requirements, tax laws, and company law and regulations.

Budget Arrangements to support the reforms under FSP III

Specific elements of the government's development expenditure program include the investment, administrative, enforcement and fiscal costs to the Government in implementing and enforcing the reforms and developing the institutional capacities called for in the FSDS 2011–2020. Each agency within the finance sector will agree with the MEF, at the beginning of each fiscal year, on the specific activities to be financed from the counterpart funds of the loan proceeds of FSP III.

Conclusion

In closing, Mr. President, we would like to reiterate that the Royal Government remains firmly committed to carry out the reform agenda under FSP III and to continue with other policy reforms already initiated since the implementation of the first financial sector development blueprint and to institutionalize those achievements. We will work in partnership and in close cooperation with ADB and other development partners.

Please be assured of the Royal Government's deep appreciation of the leading role of the ADB in developing financial sector in mobilizing financial resources and technical assistance. To keep the momentum in implementing ongoing reforms in the financial sector, we look forward to ADB's early consideration of the updated Policy Framework and approval of the proposed policy-based loan under Subprogram 3.



AUN PORNMONIROTH
Minister
Ministry of Economy and Finance



CHEA CHANTO
Governor
National Bank of Cambodia

POLICY MATRIX

Output and Milestones	Subprogram 1 Policy Actions 2011	Subprogram 2 Policy Triggers and Milestones 2012	Subprogram 3 Policy Triggers and Milestones 2013–2014	Post-Program Partnership Framework
1. Improved Legal, Regulatory, and Institutional Framework				
1.1 Update and enhance the legal foundation for banks and MFIs	i. NBC, MEF, MOC, SECC to organize a workshop attended by members of the FSIDS TWG to discuss laws that have overlapping or conflicting provisions and the need to strengthen institutional cooperation among national regulators	<p>i. NBC in consultations with MEF, MOC, MOJ and SECC to prepare amendments to the LNBC incorporating recommendations of the 2010 FSAP</p> <p>ii. NBC in consultations with MEF, MOC, MOJ, and SECC to prepare amendments of the LBFI incorporating recommendations of the 2010 FSAP</p>	<p>i. NBC to issue the necessary regulations to address the issues on the LNBC raised by the 2010 Financial Sector Assessment Program (December 2014)</p> <p>ii. NBC to issue the necessary regulations on the LBFI to address the issues including those raised by the 2010 Financial Sector Assessment Program (December 2014)</p>	Updated legal and regulatory framework to support banking and microfinance activities
1.2. Strengthen bank supervision capacity and measures adopted to improve financial stability	<p>ii. NBC supervision departments to reinforce coordination with the CAFIU</p> <p>iii. NBC to develop framework for assessing finance sector risks and issue appropriate supervisory guidelines</p>	iii. (a) NBC, MEF, and SECC to set up a two-step approach recommended by the International Monetary Fund in instituting a comprehensive coordination and cooperation framework under this approach, an initial memorandum of understanding will be signed which identifies areas of cooperation and information-sharing in order to achieve coordinated surveillance and crisis prevention. Following that, in due course, a second	<p>iii. NBC, MEF, and SECC to jointly establish clear and transparent plan of action in the event of a systemic crisis (July 2014)</p> <p>iv. NBC, MEF, and SECC to develop and arrange for adoption of the strategy to promote the use of riel (March 2014)</p> <p>v. To enhance enforcement of good corporate governance,</p>	Framework established to allow authorities to act swiftly in the event of a crisis and in dealing with problem banks

Output and Milestones	Subprogram 1 Policy Actions 2011	Subprogram 2 Policy Triggers and Milestones 2012	Subprogram 3 Policy Triggers and Milestones 2013–2014	Post-Program Partnership Framework
	<p>iv. NBC to adopt roadmap for complete fulfillment of the Basel core principles for effective bank supervision</p>	<p>memorandum of understanding will be signed which sets out a time-bound process for instituting a comprehensive crisis management framework, and (b) NBC to require banks to provide consolidated financial statements</p> <p>iv. NBC to arrange for bilateral agreements covering supervision cooperation with countries of incorporation of certain foreign banks with subsidiaries licensed in Cambodia</p> <p>v. NBC to implement key actions towards fulfillment of the Basel core principles for effective bank supervision</p>	<p>NBC to complete a corporate profile of each licensed bank (December 2013)</p>	
1.3 Strengthen prudential supervision and regulations for MFIs	<p>v. NBC to ensure full implementation of the microfinance information system to enhance quality of off-site reporting</p>	<p>vi. NBC to continue development of onsite supervision methodologies and improvement of quality of off-site supervision reports of MFIs</p>	<p>vi. NBC to arrange for a self-assessment of compliance with the Basel core principles, with suitable adjustments under Basel Committee on Banking Supervision of the Bank for International Settlements Guidance for Effective Supervision of Microfinance Activities (December 2013)</p>	<p>Enhanced supervision of MFIs based on Core Principles for Effective Banking Supervision as applied to Microfinance Activities</p>

Output and Milestones	Subprogram 1 Policy Actions 2011	Subprogram 2 Policy Triggers and Milestones 2012	Subprogram 3 Policy Triggers and Milestones 2013–2014	Post-Program Partnership Framework
1.4 Enhance legal foundation to support financial and commercial transactions	<p>vi. NBC, MOC, MOJ, and MEF to review potential conflicts between the Civil Code, the Law on Secured Transactions, and Law on Financial Leasing, with respect to provisions on financial leasing</p> <p>vii. MOC to review the operation and utilization of the on-line secured transactions registry</p>	<p>vii. MOC to obtain guidance from COM on the approach for setting up commercial courts for enforcement of financial and commercial laws</p> <p>viii. MOC to prepare a draft Consumer Protection Law</p> <p>ix. NBC to issue regulations for implementing the financial leasing law</p> <p>x. MOC to organize workshops with banks and financial institutions to help increase the use of the secured transactions registry and discuss with relevant agencies the risks and challenges on the use of the registry</p> <p>xi. MEF to submit the legal provisions covering public trust monies in the 2013 Budget Law to the COM and prepare a draft sub-decree for its implementation.</p>	<p>vii. MOC to submit the draft Consumer Protection Law to the COM (August 2014)</p> <p>viii. NBC to strengthen supervision of leasing (December 2013)</p> <p>ix. MOC to initiate to expand secured transactions registry to include leasing transactions (July 2014)</p> <p>x. MEF to submit draft comprehensive Trust Law to the COM (August 2014)</p> <p>xi. MEF to submit the new Law on Insurance to the National Assembly (March 2014)</p>	<p>Complete commercial legal framework and develop structures, systems, procedures and capacity to operationalize the commercial court</p> <p>Move towards effective enforcement of Consumer Protection Law</p> <p>Resolve legal overlaps and/or conflicts with the financial leasing law and strengthen its implementation</p> <p>Facilitate usage of secured transactions registry</p> <p>Enactment of the comprehensive Trust Law to enhance resource mobilization</p> <p>Enactment of the Insurance Law and development of life insurance market</p>

Output and Milestones	Subprogram 1 Policy Actions 2011	Subprogram 2 Policy Triggers and Milestones 2012	Subprogram 3 Policy Triggers and Milestones 2013–2014	Post-Program Partnership Framework
2. Improved Financial Infrastructure				
2.1 Modernize the national payments, clearance, and settlement system	viii. To support the rollout of the payment system, Payment Policy Unit (PPU) to prepare and submit the draft Law on the National Payments System to the NBC management ix. SECC to accredit three commercial banks as cash settlement agents for securities transactions	xii. NBC to commission the national clearing system to effect early clearance and settlement nationwide, and procure the shared switch xiii. MOC, in coordination with NBC, undertake consultations to update the draft e-Commerce Law	xii. MOC to submit the draft e-Commerce Law to the COM (December 2014)	Continue to align payments system with Core Principles for Systemically Important Payment Systems while extending services to match market requirements for the entire country. Over the medium term, move toward high-value transactions, such as the real-time gross settlement system
2.2 Enhance consumer access to credit, customer protection, and market confidence	x. NBC to issue regulations covering the operations of the CBC	xiv. NBC to assist the ABC and the CMA to incorporate and register the CBC xv. NBC in coordination with CMA conduct a study on over-indebtedness covering at least 50% female participants and disseminate results to relevant stakeholders	xiii. NBC to make the CBC operational by developing governance structure to maintain confidentiality of data and affordability of its services fees (December 2013) xiv. NBC to liaise with the ABC and the CMA to formulate and implement a financial literacy program covering at least 50% female participants (December 2013)	Reliable credit information readily available to creditors to prevent market abuses, improve client literacy, and customer over-indebtedness, reduce credit risk and improve efficiency of financial intermediation
2.3 Develop the interbank market and government securities markets	xi. NBC to encourage the operation of the interbank market using certificate of deposits as collateral	xvi. MEF to develop capacity and consider the timing of issuance of treasury bills of short duration in riel based	xv. MEF and NBC to develop bidding procedures, and auction system for government	Develop broad-based government securities market. This will also be critical to conducting

Output and Milestones	Subprogram 1 Policy Actions 2011	Subprogram 2 Policy Triggers and Milestones 2012	Subprogram 3 Policy Triggers and Milestones 2013–2014	Post-Program Partnership Framework
		<p>on a predetermined borrowing program</p> <p>xvii. MEF to develop a system for accreditation of government securities primary market dealers, in cooperation with NBC</p>	<p>securities and procedures for awarding of winning bids (April 2014)</p> <p>xvi. MEF to establish a system for accreditation of government securities primary market dealers, in cooperation with NBC (April 2014)</p> <p>xvii. NBC to introduce NCD program to improve liquidity management of banking sector (March 2014)</p>	monetary policy through the use of open-market operations in the future
2.4 Develop domestic securities market	<p>xii. SECC to approve Cambodia Securities Exchange listing rules, and ensure support infrastructure for securities market is established (underwriters, dealers, brokers and investment advisory)</p> <p>xiii. Cambodia Securities Exchange under SECC guidance is registered and officially launched</p> <p>xiv. SECC to design educational materials needed, conduct investor education across the</p>	<p>xviii. SECC in consultations with relevant financial regulators to draft sub-decree on bankruptcy related to the securities market.</p> <p>xix. SECC in consultations with NBC and MEF on conducting a self-assessment to confirm if the trading and settlement system conforms to the IOSCO core principles and the Committee on Payment and Settlement Systems/IOSCO Recommendations on Securities Settlement Systems</p> <p>xx. SECC to conduct licensing/approval/accreditation</p>	<p>xviii. SECC to submit the draft sub-decree on bankruptcy to the COM (October 2014)</p> <p>xix. SECC in coordination with NBC to undertake study on regulatory framework for credit rating agency. (June 2014)</p> <p>xx. SECC to evaluate the legal framework for (a) corporate bond market, (b) collective investment schemes, and (c) securities borrowing and lending (June 2014)</p>	Develop primary and secondary markets for equities and long-term debts to provide long-term financing for industry, agriculture, and infrastructure

Output and Milestones	Subprogram 1 Policy Actions 2011	Subprogram 2 Policy Triggers and Milestones 2012	Subprogram 3 Policy Triggers and Milestones 2013–2014	Post-Program Partnership Framework
	country and set up feedback mechanisms	<p>examinations for all securities market participants including fit and proper testing</p> <p>xxi. (a) SECC in consultations to establish customer complaint center within the SECC to address public complaints; and (b) develop capacity building and education plan, and secure funding for 3 CFA scholarships for its staff</p>	<p>xxi. SECC to conduct a self-assessment to confirm if the trading and settlement system conforms to the IOSCO core principles and the Committee on Payment and Settlement Systems/IOSCO Recommendations on Securities Settlement Systems (June 2014)</p> <p>xxii. SECC to implement capacity and education plan, and secure funding for 3 CFA scholarships for its staff (February 2014)</p> <p>xxiii. SECC to establish customer complaint center within SECC to address public complaints (January 2014)</p>	
2.5 Develop the insurance industry		xxii. MEF to undertake a promotional campaign to increase awareness about insurance to help increase market penetration	xxiv. (a) MEF to develop accounting guidelines for life insurance (March 2014)	Develop new insurance products that meet varying needs of the population and diversify the insurance portfolio. Develop life funds that can be a source of long-term funds critical to the development of the domestic capital market

Output and Milestones	Subprogram 1 Policy Actions 2011	Subprogram 2 Policy Triggers and Milestones 2012	Subprogram 3 Policy Triggers and Milestones 2013–2014	Post-Program Partnership Framework
3. Strengthened Finance Sector Governance				
3.1 Promote international initiatives on AML/CFT	xv. Based on Mutual Evaluation Report 2011, CAFIU to undertake measures to meet compliance with applicable Financial Action Task Force 40+9 recommendations xvi. CAFIU to strengthen cooperation with neighboring FIUs and related international organizations	xxiii. CAFIU to undertake risk assessment of NBC-supervised institutions, and other market institutions on AML/CFT in coordination with SECC and develop a national risk assessment framework together with a strategic implementation plan xxiv. CAFIU to conduct awareness raising on AML/CFT among casinos, non-profit organizations, and realtors	xxv. CAFIU Board to adopt national risk assessment framework together with a strategic implementation plan (August 2014)	Strengthen internal systems and capabilities for dealing with AML/CFT through constant surveillance and practice, extend coverage to both financial and non-financial organizations, and increase international cooperation network
3.2 Enhance corporate governance and transparency in the finance sector	xvii. SECC to develop framework for implementing Code of Corporate Governance for listed companies	xxv. NBC to require banks and MFIs to disclose loan terms and conditions according to a uniform framework, as well as other relevant matters that will help inform and protect clients xxvi. NBC to develop a program for aligning accounting and prudential standards with IFRSs xxvii. SECC to implement Code of Corporate Governance for listed companies while strengthening the monitoring	xxvi. NBC to arrange with the ABC to provide the gender-segregated data on regular basis (July 2014) xxvii. SECC to promote use of Code of Corporate Governance among non-listed companies and conduct	Operationalize disclosure requirement for the protection of MFI clients and promulgate guidelines for the protection of MFI clients until Consumer Protection Law becomes a reality, and develop financial literacy among the population to promote access to and use of formal financial services Promote good corporate governance among listed and unlisted corporate entities

Output and Milestones	Subprogram 1 Policy Actions 2011	Subprogram 2 Policy Triggers and Milestones 2012	Subprogram 3 Policy Triggers and Milestones 2013–2014	Post-Program Partnership Framework
		and compliance framework	educational campaign with emphasis on responsibilities of board of directors, corporate secretaries and management (June 2014)	
3.3 Establish commercial dispute resolution mechanism	xviii. MOC to arrange for registration of the qualified arbitrators and the first meeting of members	xxviii. MOC to arrange the election of the Board of Directors of the National Arbitration Center, officially establish and help operationalize the National Arbitration Center and provide support for development of local dispute resolution techniques	xxviii. MOC to continue recruitment and training of new arbitrators (June 2014)	Enhance use of dispute resolution procedures and mechanisms to speed up resolution of local commercial cases
3.4 Improve the accounting and auditing profession	xix. National Accounting Council (NAC) to provide 35 certified public accountants and 35 CAT scholarships and maintain financial support for the ongoing scholarship holders	xxix. NAC to update the Accounting and Auditing Law to remove inconsistencies and reflect international developments and submit the revised law to the COM xxx. NAC to maintain financial support for the ongoing scholarship holders, and for the training needs assessment and train the trainers for implementing the standardized IFRSs curriculum at 10 universities	xxix. NAC to resubmit the revised draft Accounting and Auditing Law to the Council of Ministers (December 2014) xxx. NAC to maintain financial support for the ongoing scholarship holders, and support the implementation of the standardized IFRSs curriculum at 10 universities (August 2014)	Strengthen accounting and audit in the country and align with international standards, where applicable

Output and Milestones	Subprogram 1 Policy Actions 2011	Subprogram 2 Policy Triggers and Milestones 2012	Subprogram 3 Policy Triggers and Milestones 2013–2014	Post-Program Partnership Framework
4. Enhanced Finance Sector Efficiency				
4.1 Modernize the business registration system	xx. MOC to review current systems to register all commercial enterprises and identify areas for improvement		xxxi. MOC to initiate to consolidate systems of company registration and storage of company data for regulatory and public access to information (June 2014)	Develop system of business registration that will help monitor company and small and medium-size enterprises financial data and disclosures and compliance with the enterprise law and regulations

ABC = Association of Banks in Cambodia, ADB = Asian Development Bank, AML/CFT = anti-money laundering and combating the financing of terrorism, CFA = chartered financial analyst, CAFIU = Cambodia Financial Intelligence Unit, CAT = certified accounting technician, CBC = Credit Bureau Cambodia, CMA = Cambodia Microfinance Association, COM = Council of Ministers, IFRSs = International Financial Reporting Standards, IOSCO = International Organization of Securities Commissions, LBFI = Law on Banking and Financial Institutions, LNBC = Law on the Organization and Conduct of the NBC, MEF = Ministry of Economy and Finance, MFI = microfinance institution, MIS = management information system, MOC = Ministry of Commerce, MOJ = Ministry of Justice, NAC = National Accounting Council, NBC = National Bank of Cambodia, NCD = Negotiable Certificate of Deposit, SECC = Securities and Exchange Commission of Cambodia.

Note: Triggers in bold. Subprogram 3 has 20 policy triggers and 11 milestones.

With changing domestic circumstances and developmental priorities, the executing and implementing agencies requested minor modifications to some of the policy triggers and milestones indicated below. These minor changes were subject to the endorsement of ADB Management. The ADB Management Review Meeting, held in August 2014, confirmed the changes to proposed items, and the additional items ii and xviii were confirmed later by ADB Management and prior to circulation of the report and recommendation of the President. They were within the medium-term program framework and would not have any adverse implication for the program.

Original Trigger/Milestone	Revised Trigger/Milestone	Reasons for the Proposed Change
i. NBC to submit the amended LNBC to the Council of Ministers (COM)	i. NBC to issue the necessary regulations to address the issues on the LNBC raised by the 2010 Financial Sector Assessment Program	The implementation has been delayed because of a larger scope of proposed amendments. This is a part of 2010 FSAP recommendations and supported by World Bank TA. NBC decided to address the issues on the two laws by issuing the supporting regulations instead of amending the laws. NBC is committed to prompt issuance of the regulations, but exact timing may need to coincide with other legislative reforms. In any
ii. NBC to submit the amended LBFI to the Council of Ministers (COM)	ii. NBC to issue the necessary regulations on the LBFI to cover issues such as those raised by the 2010 Financial Sector Assessment Program	

Original Trigger/Milestone	Revised Trigger/Milestone	Reasons for the Proposed Change
		event, NBC will confirm on the issuance of necessary regulations by December 2014.
ix. MOC to expand secured transactions registry to include leasing transactions	ix. MOC to begin expanding secured transactions registry to include leasing transactions	International Finance Corporation joined with the proposal with broader scope to improve use of the secured transaction registry, including the contract with the vendor, the review and recommendations on upgrade of software or hardware, and training of potential users. ADB continues to provide support by the national IT consultant. The update of the registry will be completed by June 2015.
x. MEF to submit draft Financial Trust Law to the COM	x. MEF to submit draft comprehensive trust law to the COM	During processing, the feedback indicated that a comprehensive trust law would be more suitable than a financial trust law. The expansion of scope was requested by the government. It was agreed and the additional inputs have been provided.
Additional achievement	xvii. NBC to introduce NCD program to improve liquidity management of banking sector	NBC has successfully introduced a new NCD program to improve the liquidity management of the banking sector in September 2013.
xvii. SECC to arrange for adoption of the draft sub-decree by the COM.	xviii. SECC to submit the draft sub-decree on bankruptcy to the COM	The implementation has been delayed because of intensive consultations with relevant stakeholders.
xxiii. (a) MEF to complete actuarial study on life insurance to develop a mortality table for Cambodia and determine premium rates on life insurance policies; and (b) develop accounting guidelines for life insurance	xxiv. MEF to develop accounting guidelines for life insurance	Life insurance sector in Cambodia is still nascent. It was established only in 2012 and counts just three life insurance companies as of 2013. It is too early to develop a mortality table. The priority is still relatively low and it was agreed to postpone and wait for further development of the life insurance market.
xxv. NBC to encourage the CMA to implement financial literacy program to cover at least 50% female participation	xxvi. NBC to arrange for the ABC to provide the gender-segregated data on a regular basis	It was pointed out that the original milestone is almost identical with the milestone xiv. NBC to liaise with the ABC and the CMA to formulate and implement a financial literacy program covering at least 50% participation by women. NBC agreed to replace with other gender-related initiative.
xxviii. NAC to submit the revised	xxix. NAC to resubmit the revised draft	Under subprogram 2, the draft law was

Original Trigger/Milestone	Revised Trigger/Milestone	Reasons for the Proposed Change
Accounting and Auditing Law to the National Assembly	Accounting and Auditing Law to the Council of Ministers	submitted to the COM. The Ministry of Justice pointed out an inconsistency in the provision on sanctions and the draft was returned to NAC. NAC further revised it for resubmission to the COM by December 2014.
xxx. MOC to consolidate systems of company registration and storage of company data for regulatory and public access to information	xxx. MOC to begin consolidating systems of company registration and storage of company data for regulatory and public access to information	World Bank joined with Trade Swap Fund (\$399,398) while ADB continued providing inputs from the national IT consultant. The system upgrade will be completed by March 2015.