ADB

CAMBODIA

FINANCIAL SECTOR BLUEPRINT FOR 2001-2010

ASIAN DEVELOPMENT BANK

KINGDOM OF CAMBODIA

NATION RELIGION KING

FINANCIAL SECTOR BLUEPRINT FOR 2001-2010

by
Byoung-Jo Chun
Xuechun Zhang
Ashok Sharma

ASIAN DEVELOPMENT BANK

Infrastructure, Energy and Financial Sectors Department (West)
December 2001

CURRENCY EQUIVALENTS
(as of 14 November 2001)

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

ABBREVIATIONS

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

NOTE

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

FORWARD

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

Progress was also made in implementing structural reforms: a two-tier banking system is being put in place and new large denominated banknotes were introduced to promote "de-dollarization"; most non-tariff barriers were eliminated; the tariff structure was streamlined; a liberal foreign investment law was adopted; and the spread between the official and parallel market exchange rates has been substantially reduced. Since then, Cambodia has made impressive strides in re-establishing political and economic stability and re-integrating itself into the international community. However, the Government is conscious that an economy will not reach its growth potential and develop at an adequate pace, without an active contribution from the financial sector. Therefore, the Government is committed to strengthening the financial system and, over the recent years, has been enacting legislation, adopting policies, creating institutions and adapting procedures as part of the financial sector reforms in order to quicken the pace of economic growth.

Financial sector development is important to the speed and direction of economic growth, since a strong and well-functioning financial sector can break down the limitations of self-financing, mobilize idle financial resources for productive investment needs. To link up saving, investment and economic growth, the financial sector development must go hand in hand with private sector development and governance reform, forming three pillars to underpin the Government’s policy of generating growth, which is seen as the major means to reduce people poverty, the ultimate goal of the Government’s economic policy.

The banking sector in particular needs strengthening, given its current low level of development and its dominant position in the present financial system. Cambodia's banking system was thus transformed from a mono banking into a two tier banking system by separating the central bank functions from commercial banking activities. To support the reform, legislative framework has been improved. The new central bank law is promulgated in January 1996, providing better clarification of the Bank's status, ownership and capital structure, and laying a more solid foundation for its operations. Along with re-defining the new role of the National Bank of Cambodia, the Government is fully aware of the need to address the remainders of the financial system with a view to establish a modem and efficient financial sector. The Law on Banking and Financial Institutions, enacted in November 1999, represents therefore a great asset for the nascent's financial sector. This new law responds to the need to promote a sound financial structure and orderly financial markets by providing appropriate legal framework for the licensing, organisation, operation, and supervision of a broad range of financial services companies. In addition, the Insurance Law was passed in June 2000.

To strengthen the banking system in the earlier 2000 the National Bank of Cambodia introduced bank-restructuring program, requiring the existing banks to increase their capital base and to comply with relevant laws and regulations. As a result, in November 2000, nineteen banks were allowed to continue operations, while twelve others were de-licensed and put under liquidation procedure. With these actions, the Government has in mind to bring up all existing banks to a higher standard, improving the soundness and reliability of the banking system, which is crucial for confidence building.

While much progress has been made in recent years in financial sector reform, still many things remain to be done to support increased investment and high and sustainable economic growth rate. Creating a modern and efficient financial system is not an easy task. The Government needs to fully understand what it needs, which direction to go and how to get there. In this spirit, the Government has requested assistance from the Asian Development Bank (ADB) to develop a financial sector development plan for Cambodia. In fully understanding the need of Cambodia, ADB has positively responded to the request and started its assistance with an initial sector study to develop strategic objectives and identify key issues in the financial sector. Through this study, a preliminary financial sector "roadmap" was drafted in June 1999.

Based on this preliminary document, ADB launched a project preparation technical assistance in December 2000 (TA 3467-CAM: Preparing the Financial Sector Development Program) to assist the Government in producing a practical and implementable master plan for the financial development for the next 10 years. Also for this purpose, on the side of the Government, the Committee on Economic and Financial Policies, established by the governmental decree dated 10 June 1997 and chaired by the Minister of Economy and Finance, entrusted H.E. Chea Chanto, Governor of the National Bank of Cambodia and Deputy Chairman of the Committee on Economic and Financial Policies, to lead a Financial Sector Steering Committee (FSSC), established in April 2000, with senior representatives from the Ministry of Economy and Finance, the National Bank of Cambodia, the Ministry of Commerce and the Council of Development of Cambodia as members, in order to ensure the ownership of this important master plan. In addition, a Working Group (WG), which consisted of representative of the above institutions, was set up to assist the FSSC in all technical aspects related to the matter. The National Bank of Cambodia acted also as the executing agency and coordinator with the ADB.

In the course of preparing the Blueprint, numerous meetings were organized, including the consultation and consensus-building seminars to solicit views from across the interested spectrum and to build a common understanding on the future prospects of the financial sector in Cambodia. The whole process has been marked, by a partnership between the Government and the private sector in taking strong ownership of financial sector reform in Cambodia.

Thank to the efforts of all parties involved, especially, the Cambodia Team of ADB's Financial Sector and Industry Division, in July 2001 a draft Blueprint called " Vision and Financial Sector Development Plan for 2001-2010 " has been finalized. On the 24th August 2001 during a plenary session at the Council of Ministers, chaired by Samdech Hun Sen, the Government adopted the document as an official long-term plan for the financial sector development and is part of an overall Government’s reform agenda toward establishing a more market-based, open, and private-sector led economy.

With the Blueprint, each important component of the financial sector that is being developed or will be developed by individual and separate efforts of the relevant organizations have been coordinated, streamlined in a handed and systematic manner and reflected in one document.

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

(i) a competitive, integrated, and efficient banking system that is properly regulated and supervised and effectively mobilizes savings to provide financing to support the growth of the private sector, a reliable payment system and banking safety nets.

(ii) a viable, pro-poor and effective rural finance system for providing affordable financial services to enable the poor to enhance rural income and reduce poverty.

(iii) an insurance sector that protects businesses and individuals from catastrophic events and a pension system that provides a secure retirement, both of which provide capital for long-term investment in the real sector.

(iv) diverse non-banking financial products and institutions that create more balanced financial structure, increase the depth of financial market, and promote competition. These include leasing business, money market and capital market intermediaries, and development finance institutions.

(v) a money market that enables an inter-bank market that provides banks, companies, and individuals with the means for effective liquidity managing.

(vi) an efficient and transparent capital market with a critical mass of issuers that mobilizes funds for long-term investment.

(vii) legal and accounting systems that promotes the rule of law in commercial and financial transactions and support good governance by promoting transparency, accountability, and predictability.

The Financial Sector Development Plan also emphasizes, in addition to the institutional and legal strengthening of the financial sector, the need to develop a reliable financial information system and to introduce an efficient mechanism to build up manpower capable to face with the future challenges.

To ensure its successful implementation, the Blueprint has been structured as a step-by-step plan. Intermediate reform agenda has been formulated to help identify specific measures and to set the sequence and pace for the implementation of those measures. Another important feature of it is the built-in flexibility within the reform agenda, which allows the Government to make necessary policy adjustment to reflect progress made along with the changing conditions.

The Government of Cambodia wishes to express its special gratitude to the Asian Development Bank for producing this important document. Without the Bank's invaluable support, guidance and technical assistance, the realization of this paper would not have been possible.

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

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

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

Phnom Penh, 2 October 2001

Keat Chhon
Senior Minister
Minister of Economy and Finance

Chea Chanto
Governor
National Bank of Cambodia

PREFACE

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

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

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

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

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

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

between the Government and the private sector in taking strong ownership of financial sector reform.

We would like to extend special gratitude for the leadership and guidance of H.E. Keat Chhon, Senior Minister of the Ministry of Economy and Finance; H.E. Chea Chanto, Governor of the National Bank of Cambodia; and H.E. Sok Siphana, Secretary of State, Ministry of Commerce. In addition, significant contributions and guidance were provided by the following from the Ministry of Economy and Finance: H.E. Aun Porn Moniroth (Secretary General), H.E. Ngy Tayi (Under Secretary), Mey Vann (Deputy Director), Pen Thirong (Deputy Director), Ken Sambath (Deputy Director and Assistant to Senior Minister), Minh Ban Kosal (Secretary Group to the Prime Minister and Assistant to Economic Advisor to the Prime Minister and Secretary General), Vong Bunintreavuth, and Rath Sa Rath; and by the following from the National Bank of Cambodia: H.E. Sum Sannisith (Secretary General), Tal Nay Im (General Director), and Nguon Sokha (Deputy Director). Special thanks also go to all private sector participants in the seminars, notably, Sok Kong (President, Phnom Penh Chamber of Commerce), Ow Soon Wing (SBC Bank, Singapore Banking Corporation Ltd.), Chan Kok Choy (General Manager, Cambodia Public Bank Ltd.), and S. Choy (First Overseas Bank).

Equally important, we would like thank Christine Wallich (Director, Infrastructure, Energy and Financial Sectors Department, West) and Thomas Crouch (Manager, Financial Sector and Industry Division, West) for their continuous encouragement and support. We also wish to acknowledge the essential contributions and groundwork of the consultant team led by Arun Hsu (Financial Sector Specialist) and comprising Donald Simonson (Economist), John McCoy (Banking Expert), John Hepp (Accounting Expert), Tia Savora (Economist), and Nay Chhuon (Training Coordinator). Finally, we are grateful to Thomas Rumbaugh (Deputy Division Chief, Asia and Pacific Department, International Monetary Fund) and his mission for sharing their valuable experiences and providing support along the way.

Byoung-Jo Chun
Financial Economist
Team Leader of Cambodia Team
Financial Sector and Industry Division
Infrastructure, Energy and
Financial Sectors Department (West)

Xuechun Zhang
Economist
Cambodia Team
Financial Sector and Industry Division
Infrastructure, Energy and
Financial Sectors Department (West)

Ashok Sharma
Project Economist
Agriculture and Rural Development Division
Agriculture and Social Sectors Department (West)

EXECUTIVE SUMMARY

Financial sector development in Cambodia, under the current socioeconomic and legal environment, poses a daunting challenge to the Government as well as to the private sector. Although efforts have been made on many fronts, it is the view of the Government that Cambodia needs to exert coherent and systematic efforts to develop a sound market-based financial system to support resource mobilization and broad-based sustainable economic growth.

With these objectives in mind, the Government has formulated a long-term vision and development strategy for the financial sector with ADB technical assistance. The vision and strategy were developed based on key lessons drawn from the experience of other Asian economies in financial sector development, as well as from the current situation in Cambodia.

Long-term Vision and Development Strategy

Financial sector development crucially depends on governance reform. One of the critical governance challenges facing Cambodia is to strengthen the accountability of institutions in the public sector. The necessary reforms include, among others (i) legal and judiciary reform, (ii) public administration reform, and (iii) public finance reform.

If the governance reform programs envisaged in the Socio-Economic Development Plan II and the Governance Action Plan are fully implemented, it is expected that the Cambodian economy will be able to sustain an average annual economic growth rate of 6-7 percent over the medium term.

Building on such development prospect, the Blueprint anticipates that the financial sector will at least double in terms of the ratio of financial assets to gross domestic product in 10 years. The spread between loan and deposit rates will narrow as intermediation becomes more efficient owing to macroeconomic stability, improved legal and financial infrastructure, and increased competition among banks and other financial institutions.

The vision will be achieved by ensuring the following:

(i) a competitive, safe, and sound banking system that is well regulated and supervised, and effectively mobilizes savings to provide financing to support the growth of the private sector;

(ii) the establishment and development of nonbank financial institutions (NBFIs) that will increase the depth of the financial sector by providing a broad array of diversified services such as leasing and consumer finance;

(iii) an insurance sector that protects businesses and individuals from catastrophic events and a pension system that provides a secure retirement, both of which provide capital for long-term investment in the real sector;

(iv) a safe and reliable system for the transfer of funds between customers and banks, and for the settlement of payments between banks;

(v) money/interbank markets that provide banks, companies, and individuals with the means for effective liquidity management;

(vi) efficient and transparent capital markets with a critical mass of issuers that mobilize funds for long-term investment;

(vii) a legal system that promotes and enforces the rule of law in commercial and financial transactions and that supports good governance by promoting transparency, accountability, participation, and predictability;

(viii) an accounting and auditing system based on international standards that supports good governance by promoting transparency, accountability, participation, and predictability; and

(ix) human resource development employing performance-based compensation and promotion and the availability of a broad range of professional programs to retrain existing staff and provide ongoing training.

The Government has adopted a long-term strategy for financial sector development that comprises the following elements:

(i) maintaining sound fiscal and monetary policies to ensure macroeconomic stability;

(ii) establishing a sound legal framework to protect property rights and enforce contracts;

(iii) establishing the rule of law through legal/judicial reform to underpin financial and commercial activities;

(iv) sequencing efforts to develop financial infrastructure, particularly the payment/clearing system, accounting and auditing system, credit information system, and regulatory framework;

(v) 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;

(vi) 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;

(vii) establishing a sound framework for private sector development in the financial system by phasing out state ownership and state intervention in the system;

(viii) developing a transparent entry framework to encourage efficiency and financial deepening;

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

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

Sector Development Plan

Under the guidance of the long-term strategy, the Blueprint details sector development strategy and policy reform agenda. The sector development plan explicitly considers the interrelationship of (i) human and institutional capacity building, (ii) developments in related financial infrastructure, (iii) establishment of a legal and regulatory framework, (iv) emergence of relevant financial markets, and (v) availability of technology. The sector development strategy is a rolling plan, which needs continuous updating to reflect the Government's achievements as well as the changing socioeconomic environment. The Government is committed to implementing the sector development plan specified in the Blueprint, as well as to continuously updating the sector development plan to reflect the Government's achievements and the changing socioeconomic environment, thus maximizing the development impact.

The Banking Sector

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

The Insurance Sector and Pension System

The development of the insurance sector will also go through three phases. To improve the current weak legal infrastructure and supervisory capacity, the first phase aims at establishing the foundation and building capacity for the sector. With a solid foundation in place, the insurance sector will develop in size and diversity. The focus of the second phase will be to promote the insurance market through private sector development, to increase the outreach to poor and rural areas, to implement compulsory insurance, and to enhance product variety. The implementation of compulsory insurance will create policy-driven demand, and the growing income will generate demand for a greater variety of insurance products. In response to the growing sophistication and volume of business in the insurance sector, an independent insurance supervisor will be established. As the sector further expands, the independent insurance supervisor will further upgrade prudential regulations in the third phase.

During the first phase of pension system development, the feasibility and design for establishing a multi-pillar pension system will be completed. During Phase II, the legal, regulatory, and supervisory frameworks will be established for the pension system. In addition, a capacity-building mechanism will be needed to ensure properly trained staff in the regulatory and supervisory body. During Phase III, the legal framework will be enhanced through the issuance of sub-decrees. The mandatory public pension program will be launched and the supervisory and regulatory framework will be further strengthened in anticipation of the implementation of the mandatory privately managed funded pension program that will be implemented after Phase III.

Nonbank Financial Institutions

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

Interbank/Money Markets

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

Capital Markets

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

Financial Market Infrastructure

Legal Infrastructure. The development of the legal infrastructure for financial markets also targets three reform agenda over the next 10 years. The goal in Phase I is to introduce key laws pertaining to commercial activities to underpin financial sector development. In Phase II, law enforcement will be strengthened with the progress in court reforms and capacity building. Phase III will focus on enhancing legal infrastructure for private sector development; during the period, a legal framework for public registration system for movables will be established.

Accounting and Auditing System. The accounting and auditing system is the base for financial sector development and demands urgent attention. The goal in Phase I is to establish accounting and auditing standards and a system for their enforcement through promulgation of a Law on Corporate Accounts, their Audit and the Accounting Profession; adoption of International Accounting Standards/International Standards on Auditing; and establishment of an accounting professional body and an accounting standards board. In Phase II, the accounting association will strengthen the enforcement of accounting and auditing standards, and promote competition in the accounting industry to reduce the accounting and auditing compliance costs of the private sector. In Phase III, enforcement of accounting standards and expansion of International Accounting Standards to more firms will occur.

Financial Information Infrastructure. Development of a financial information system is crucial to cultivate a credit and repayment culture in the early stage of financial development. In Phase I, the Government will create the financial market information system via banker-led arrangements for sharing credit information. During Phase II, the Government will expand the scope of the arrangements to nonbank institutions. In Phase III, the financial market information system will be further diversified by introducing a credit rating industry.

Financial Sector Safety Nets. Financial safety nets will be developed to bolster public confidence in the financial system. As the financial system expands, so do the systemic risks. The development of the financial safety nets includes a two-stage reform agenda starting from Phase II. The goal of Phase II is to develop banking sector safety nets with the establishment of deposit insurance and corporate governance guidelines. Phase III will expand the deposit insurance system to the nonbanking sector participants who join the payment system.

Successful implementation of the Blueprint relies on strong leadership, firm commitment, and tremendous efforts by the Government, especially, the Ministry of Economy and Finance, the Ministry of Commerce, and the National Bank of Cambodia. It also calls for the support of the private sector and the timely assistance of international aid agencies, since the active participation of the private sector and international agencies is indispensable as a source of knowledge input for successful implementation of the Blueprint.

CONTENTS

I. INTRODUCTION

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

2. The Socioeconomic Development Plan for 1996-2000 (SEDP I) marked the Government's first systematic efforts toward economic development to achieve economic growth, poverty reduction, and broad participation in the development process. Since the successful implementation of SEDP I, the Government has been engaged in finalizing the Socioeconomic Development Plan for 2001-2005 (SEDP II), which identifies poverty reduction as the primary development goal. SEDP II targets reducing the poverty rate from 36 percent[1] in 1999 to about 31 percent in 2005, as well as lessening the degree of deprivation. These rates will be achieved by (i) promoting broad-based, sustainable economic growth at a rate of 6-7 percent with equitable income distribution, (ii) facilitating social and cultural development, and (iii) ensuring the sustainable management and use of natural resources and the environment.

3. The Government's strategy to accomplish the poverty reduction target is to promote growth in all sectors but especially in the agriculture sector, because about 90 percent of the poor live in the rural areas. Moreover, mobilization and efficient allocation of resources are at the core of the economic development strategy. Specifically, the Government has targeted the following areas:

(i) implementing fiscal reforms and maintaining a stable macroeconomic environment;

(ii) improving the efficiency and effectiveness of the public sector through reforms in civil service, judiciary, and public enterprises;

(iii) enhancing private sector development while protecting public interests by (a) improving physical infrastructure, (b) developing the legal and regulatory frameworks within which business enterprises operate, (c) liberalizing trade and investment policies, and (d) supporting banking system reform and financial sector development;

(iv) promoting agricultural development and off-farm employment creation in both rural and urban areas; and

(v) empowering the poor to participate in, and thus benefit from, the growth process by improving their access to natural assets, health and education services, appropriate technology and credit, and by removing any antipoor distortions in product and factor markets.

4. A sound and efficient financial system is essential for achieving broad-based economic growth and socioeconomic objectives, including poverty reduction. A well-functioning financial

[1] The poor are those with a per capita income level below the poverty line, which was KR54,050 per head per month, equivalent to about $14 (less than $0.50 per day).

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

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

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

7. **Enabling Macroeconomic Policy.** An important component for achieving and sustaining macroeconomic stability is a sound monetary policy to support growth, control inflation, and promote the strengthening and deepening of the financial sector to increase the mobilization of savings that supports private sector growth. With the development of a sound financial system, the Government can be better equipped with monetary policy tools.

8. **Safeguarding the Economy from External Shocks**. Developing a robust financial sector will protect the economy from or minimize the impact of external shocks, which are becoming more common with globalized financial markets. As the recent financial crisis attested, those Asian countries with the stronger legal and banking supervisory frameworks were more capable of minimizing the negative effects of the massive disruption in the regional market than the countries with weaker frameworks.

9. **Promoting Foreign Direct Investment**. A transparent financial system is also essential for attracting FDI, which have been the driving forces for economic growth in Cambodia. Because the availability of reliable means for conducting financial transactions is essential for the viability of the investments, a sound and efficient financial system is the fundamental condition to attract FDI. Foreign investors tend to invest in countries with sound governance that fosters transparency, accountability, and predictability, and promotes wide participation of the private sector by establishing the rule of law and a sound and efficient financial sector.

10. In recognition of the strategic value of financial sector development, the Government requested the Asian Development Bank (ADB) for assistance in formulating a long-term vision and a financial sector development plan for the 10-year period, 2001–2010. In response to the Government's request, ADB conducted a comprehensive diagnostic review of the financial system from 2000 and formulated a financial sector development plan, or the Financial Sector Blueprint (the Blueprint) for 2001-2010.

11. The Blueprint outlines a long-term vision and strategy for sequencing policy reforms to develop the financial system over three phases during 10 years. The Blueprint addresses key policy issues in the banking and nonbanking sectors, contractual savings, and interbank/money and capital markets, as well as the basic infrastructure to underpin the development of the

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

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

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

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

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

13. Aid coordination is a key component underpinning the Blueprint strategy. Given the extent of issues that need to be addressed in financial sector development, such coordination will be critical to the effective allocation of resources. Funding agencies will be able to use the Blueprint to plan and coordinate technical assistance (TA) to the financial sector. In addition, duplication will be minimized through better planning and communication, which will be facilitated by the Blueprint.

14. The remainder of this document is organized as follows. Chapter II reviews the background of and analyzes the key issues in Cambodia's financial sector. Chapter III presents a long-term vision for financial sector development, and Chapter IV provides the long-term strategy and sector development plan to achieve the vision. A summary table of the Blueprint is in the Appendix.

II. KEY ISSUES IN THE FINANCIAL SECTOR

A. Overview

15. Cambodia's financial sector is at a rudimentary stage, with limited financial intermediation and low public confidence. Cambodia still has one of the lowest rates of banking intermediation in the world: bank loans and deposits account for approximately 8 percent and 12 percent of gross domestic product (GDP), respectively.

16. Cambodia had a monobanking system when the National Bank of Cambodia (NBC) operated through its provincial branches. Structural reforms were initiated in 1989 through a Government decree to establish a two-tier banking system by separating the function of commercial banks from NBC. This decree allowed the formation of private commercial banks as limited liability companies. In 1990, treasury operations were transferred to the Ministry of Economy and Finance (MEF), and NBC was designated as a ministry and largely used to finance budget deficits. In 1991, the first private commercial bank was established as a joint venture between NBC and the Siam Commercial Bank of Thailand. Commercial banks operated under the framework of a law on the supervision of financial institutions, which was enacted in August 1992, and the subdecree on the supervision of commercial banks approved in November 1992. In 1996, NBC was established as the central bank as the result of the promulgation of the Law on the Organization and Conduct of the National Bank of Cambodia (the Central Banking Law).

17. The period of political stability has allowed steady progress in the Government's efforts toward financial sector development. Following the reestablishment of NBC in 1996, the

Government adopted the Law on Banking and Financial Institutions (the Banking Law) in 1999 and a new Insurance Law in 2000. The Banking Law introduced more appropriate definitions for banking activities and a refined legal framework for banks. It also allowed microfinance institutions (MFIs) to undertake financial operations under the supervision of NBC. Furthermore, in 2000 the Government embarked on a comprehensive bank ~~-~~restructuring program with the assistance of the International Monetary Fund (IMF) to enhance public confidence in the banking system.

18. Currently, Cambodia has just 20 commercial banks as a result of NBC's relicensing program, which revoked the licenses of 12 nonviable banks. Other financial institutions operating in Cambodia include insurance companies, currency exchange bureaus, and MFIs. In the rural areas, banking activities are even scarcer; the microfinance operations of nongovernment organizations (NGOs) are the main and de facto providers of credit there. The insurance sector comprises a Government-owned insurance entity, the Cambodia National Insurance Company (CAMINCO), which acted as the regulator, underwriter, and broker; and four nongovernment insurance companies that are agents for CAMINCO and risk underwriters through fronting agreements. There are no recognized interbank/money markets or capital markets. Development of these markets will depend on proper legal and accounting infrastructure, necessary regulatory and institutional structures, and human resource capacity.

19. Weak financial infrastructure hampers the further development of the financial sector. Cambodia has yet to develop or strengthen laws pertaining to accounting, insurance, negotiable instruments, secured transactions, commercial enterprises, bankruptcy, contracts, commercial credit, and the like. In addition, public confidence in the judicial system is very low. The lack of the rule of law prevents the development of a formal, contract-based credit culture and has thus been a primary impediment to private sector development. Cambodia has yet to adopt common accounting and auditing standards. Few companies produce financial statements, and those that do ~~usie~~use different standards. Lack of common accounting standards and an enforcement system has not only increased the risk and cost of banking operations but has also deterred the development of financial markets.

B. The Banking Sector

1. Background

20. To strengthen the banking system, NBC recently conducted a bank relicensing program based on increased capital requirements and the CAMELS rating system. In November 2000, just before the first phase of NBC's bank relicensing program, the commercial banking system consisted of 31 banks, including two Government-owned banks, 22 locally incorporated banks, and 7 foreign bank branches. In December 2000, NBC revoked the licenses of 12 banks classified as nonviable, and placed 16 banks under conditional licenses, entering into memoranda of understanding that required compliance with restructuring measures and prudential regulations (for example, minimum capital requirements) by the end of 2001.

21. The five largest commercial banks, including the Government-owned Foreign Trade Bank (FTB), hold more than 50 percent of total banking assets and deposits. Deposits in foreign currencies, predominantly US dollars, make up 93 percent of total banking deposits. The US dollar is the primary medium of exchange, with the Cambodia r~~r~~iel (KR) used primarily in rural areas. The formal banking sector is concentrated in Phnom Penh, although 90 percent of the population resides in rural areas.

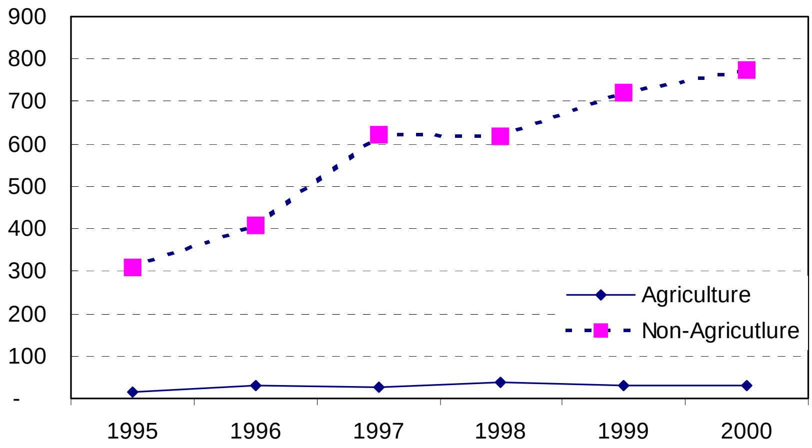
22. As of December 2000, the total assets of the banking system stood at KR2,517 billion – the equivalent of $644 million, or 20 percent of GDP. This represented an increase of 20 percent since the end of 1999. During the same period, loans increased 31 percent to an equivalent of $249 million, while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

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

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

Source: National Bank of Cambodia.

Figure 1. Bank Loan by Sector (KR Billion)



Source: National Bank of Cambodia.

23. Despite the low level of lending, asset quality in the banking system is poor. According to NBC, the volume of nonperforming loans in the banking system is reported to be substantial and growing. The lack of both accounting standards and a uniform chart of bank accounts compounds concern about the accuracy of the reported nonperforming loans.

24. In addition, the banking sector maintains excess liquidity with the percentage of cash to total assets at about 19 percent. Roughly 33 percent of total assets are non-earning. The banking system provides a narrow range of financial products, usually limited to demand, savings, and time deposits on the liability side. Loan portfolios tend to be confined to better-known firms.

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

2. Constraints and Issues

26. A number of factors contributing to the low level of intermediation, poor asset quality, and high operating costs for banks all lead to low public confidence and limited deposit mobilization. As a result, the bulk of money in the economy is held outside of the banking system.

27. Uncertainties regarding the enforceability of security interests impede bank lending and contribute to poor asset quality. The present collateral registration system is unreliable because of the absence of a legal basis for secured transactions and an inadequate public registration system that specifies lenders' positions and priority rankings in secured property. The current collateral registration system is cumbersome and requires banks to go through several steps to identify, confirm, and register a secured interest. In addition, lack of a proper collateral valuation system also inhibits sound lending.

28. Lack of reliable borrower information impedes bank lending and leads to poor asset quality. Cambodia lacks a credit bureau or arrangements for sharing information among financial institutions that can be accessed by all banks. Further, few firms produce financial statements, and no common accounting standards are enforced. Thus, banks are unable to lend based on cash-flow analysis, as they lack clients' financial information. Consequently, banks are compelled to lend against collateral as the primary source of repayment, which is further compromised by a lack of infrastructure for secured transactions.

29. The lack of liquidity management mechanisms resulting from underdeveloped financial markets incurs substantial opportunity costs to banks. The banking sector maintains an abnormally high level of liquidity because of the lack of interbank markets to effectively manage liquidity. In addition, although the Central Banking Law provides the legal basis for rediscount facilities,[2] NBC is unable to provide liquidity service to commercial banks to meet temporary liquidity shortages, because all eligible negotiable instruments (bills of exchange, promissory notes, etc.) are unavailable because of the lack of necessary legal infrastructure (i.e., a negotiable instruments law).

30. The weak supervisory capacity and regulatory framework impede early identification of problem banks and their timely and orderly resolution. The basic framework and the capacity for on-site inspection and off-site surveillance, as well as a prompt corrective action system, are not yet in place. Weak capacity and shortcomings in the legal and regulatory framework for bank

[2] "The Central Bank shall determine the procedures or repurchase from, sell to, discount and rediscount for banks and financial institutions: (a) bills of exchange and promissory notes drawn or made for bona fide commercial, industrial or agricultural purposes, bearing two or more good signatures one of which must be that of a commercial bank and maturing within 90 days from the date of their acquisition by Central Bank…; and (c) any private negotiable claims on the money market as well as all bankers claims bearing creditworthy signature and appearing on a list recognized by the Board," Article 36, Central Banking Law.

liquidation have hampered and delayed early and orderly liquidation of delicensed banks. Bank regulations and the capacity of the Bank Supervision Department of NBC both need strengthening. In addition, lack of a uniform chart of bank accounts and disclosure rules hampers effective bank supervision and prudential regulations. Like their borrowers, commercial banks adopt varying accounting standards. Furthermore, a review of sample financial statements of commercial banks revealed that the quality of the audits performed by international firms is inconsistent, partially as a result of the lack of common accounting and auditing standards within Cambodia.

31. Finally, the banking system suffers from a lack of human resource capacity. The early market opening policy has enabled Cambodia to attract many experienced foreign commercial bankers into the banking sector. As a result, most senior managers are experienced and competent bankers. However, most banks have difficulty finding qualified working-level staff because of the country's legacy of long-standing domestic turmoil and international isolation. Thus, most working-level staff need substantial professional training in basic banking operations such as credit analysis, loan monitoring, and problem loan management.

C. Rural Finance

1. Background

32. The rudimentary banking system cannot address the nature of demand from the poor for microfinance to smoothen consumption, build assets, and develop microenterprises. Furthermore, it is not structured to meet the demand from the middle and upper segments of the rural markets for financing commercial cultivation, agricultural trading, and rural and agriculture-related enterprises such as rice milling and dairy.

33. Nearly 40 percent of the people have no access to formal bank branches. Only 6 percent of total banking sector advances is for agriculture or related activities, primarily short-term dollar-denominated loans. The estimated rural finance demand of $120-$130 million per annum, of which one third is for microcredit ranging from $50 to $300, is only fractionally met from institutional sources. Reliable savings facilities are generally not available in rural areas or to the poor.

34. Currently, about 90 NGOs supported by funding agencies such as Kreditanstalt fur Wiederaufbau, Gesellschaft fur Technische Zusammenarbeit of Germany, United Nations Children's Fund, International Fund for Agricultural Development, United States Agency for International Development provide microfinance to nearly 420,000 poor households, or 15 percent of the total, with most of the borrowers being women. In 2000, the estimated aggregate outstanding microcredit was $30 million, and savings mobilized was $1.4 million. Service delivery is through "village banks" consisting of 100-200 members and managed by a village credit committee. Members are organized into groups and are provided with some basic training; they are given individual credit with group liability. Loans varying from $20 to $300 are provided for 3-12 months with equated installments and incentives for timely repayment. Interest rates on loans range from 3 to 5 percent per month. Repayment rates are 80-95 percent. The balance of ~~mc~~mic~~i~~rofinance is supplied by informal sources, either based on reciprocity and social obligations or from moneylenders and input suppliers.

35. Cognizant of the issues, the Government has adopted the Rural Credit Policy to develop an effective rural financial system, and has initiated the Rural Credit and Savings Project[3] and TA for Capacity Building for Rural Financial Services,[4] the policy measures under which include (i) introducing an enabling provision in the Banking Law for eligible NGOs and other rural finance service providers to become regulated licensed MFIs; (ii) creating a Microfinance Supervision Department (MSD) within NBC to undertake off-site and on-site inspection of licensed MFIs, and specialized to monitor the financial activities of NGOs; (iii) establishing the Rural Development Bank (RDB) as an apex institution to provide financing for MFIs and commercial banks and to extend technical support and training to MFIs; and (iv) enhancing collaboration among the Government, NBC, and NGOs for the promotion of sustainable rural finance. The Government intends to actively encourage the entry of commercial banks into rural finance, strengthen NBC's capacity to ensure orderly development of the sector, and make RDB a sustainable apex institution. Agent Francais de Development also provided technical and financial assistance to build up the supervisory capacity of NBC with regard to the supervision of MFIs with a view to ensure their sustainable development.

2. Constraints and Issues

36. Although many factors contribute to poverty, its most obvious manifestations are insufficient household income, lack of productive assets, and inaccessibility of affordable financial services. In response, the Government has prioritized the development of a policy and institutional framework for rural finance. Nevertheless, rural finance faces a number of constraints in expanding outreach and attaining sustainability.

37. The demand-supply gap for institutional rural finance, even at the current level of economic activities, is significant. The majority of rural households, including the poor, have no access to institutional finance at affordable terms. Although the collective outreach of the informal sector (that is, friends, relatives, money lenders, input suppliers, etc.) is large, the terms and conditions limit the ability of rural households to participate actively in and benefit from the development process.

38. The demand for savings, although not quantified, is significant and largely unmet because of (i) the absence of secure and reliable savings facilities, (ii) the lack of appropriate products, (iii) the high cost of service delivery, (iv) inaccessibility, and (v) the relative inexperience of NGOs in managing savings. The supply side is dominated by microcredit characterized by short-term loans. The supply of term credit for the agriculture and rural sector is seriously constrained by the lack of institutions capable of delivering and managing term credit and by the lack of long-term funds. This undermines efforts to diversify agriculture and ~~promtoe~~promote exports. Weak contract enforcement also deters term financing. The network, orientation, institutional capability, and financial health of commercial banks combine to make them only marginal suppliers of short-term rural finance.

39. The majority of NGOs, the sole as well as de facto suppliers of microfinance in rural areas, exhibit (i) weak systems and procedures, (ii) reliance on Government or external assistance, (iii) lack of commitment to sustainability, and (iv) inadequate realization of the need to specialize for efficient delivery of financial services.

[3] Loan CAM 1741: *Rural Credit and Savings Project,* for $20 million, approved on 20 April 2000.
[4] TA CAM 3270: *Capacity Building for Rural Financial Services*, for $1.45 million, approved on 10 October 1999.

D. The Insurance Sector

1. Background

40. The insurance sector consists of a Government-owned insurance entity, CAMINCO, which acted as both regulator and underwriter, and four private insurance companies that are performing as agents for CAMINCO. As part of the current restructuring and corporatization program, CAMINCO will be transformed into a private company through a joint venture with a private insurance company. The Government is expected to sign a joint venture agreement with the candidate company soon, in which the company will have 49 percent of the shares and MEF will hold 51 percent.

41. Most of the policy purchasers in Cambodia are foreign investors and international organizations, and the main sources of business include property, health, marine cargo, and motor vehicles. CAMINCO has also made arrangements for reinsurance facilities with markets in the region and European countries. Other products expected in the future include livestock, crop, and life insurance.

42. In 1992, the Law on the Establishment of the Insurance Business in Cambodia was adopted. During 1992-1996, subdecrees, circulars, and declarations were issued to address the management of the insurance business, the scope of business, and the establishment of private insurance companies.

43. The year 2000 was a watershed period in the development of the insurance sector. The National Assembly adopted the Insurance Law, and the Government moved forward with the privatization of the state-owned insurance company. The new Insurance Law covers property insurance, life, and personal insurance; compulsory third party liability motor vehicle insurance; construction insurance and insurance for passenger transport; insurance company and state control; insurance agents and brokers; and legal penalties. The Government is drafting a subdecree to implement the new law. The first draft has been submitted to the Council of Ministers for approval and is expected to be effective this year.

44. In anticipation of the privatization of CAMINCO, its regulatory responsibility was transferred to the Insurance Office that was established under the Financial Industry Department of MEF in January 2001. Key staff in the Insurance Office came from CAMINCO. On 4 January 2001, the Government also nominated the former President of CAMINCO as the Insurance Commissioner.

2. Constraints and Issues

45. First, the insurance sector has been constrained by a weak supervisory and regulatory framework and capacity, low levels of income in the country, and lack of public awareness of the sector. Although the Government adopted the new Insurance Law in 2000, it has yet to adopt implementing subdecrees and basic prudential regulations, such as uniform chart of accounts and solvency requirements.

46. Second, an effective enforcement and monitoring mechanism to implement compulsory insurance needs to be established. Although the new Insurance Law is a framework law for the insurance business, compulsory insurance cannot be fully implemented by such a framework law alone but needs supporting legislation to establish an enforcement and monitoring system. This in turn requires significant interministerial effort and coordination.

47. Third, the framework for private sector development in the insurance sector needs to be strengthened. The introduction of compulsory insurance would create a policy-driven demand for insurance. Without a competitive framework for the private insurance business, it would be difficult to implement and develop compulsory insurance. The Government has already taken an important initiative toward private sector development by adopting a privatization policy for CAMINCO. However, two issues still need to be addressed to facilitate private sector development: The Government should make an effort to divest its ownership in the insurance sector. Although MEF is now responsible for insurance supervision, the Government's share in the largest insurance company poses a conflict of interests in supervision and will affect competition in the insurance market. Thus, the partial privatization of CAMINCO through a joint venture should ultimately lead to divestiture of the Government shares in the joint venture over the medium term. In addition, the Government needs to develop a transparent entry mechanism to foster competition by creating a level playing field for both state-owned and private companies.

48. Finally, the new insurance supervisor needs substantial capacity building. MEF has successfully retained experienced regulators from CAMINCO, but additional staffing and substantial capacity building are still needed to help CAMINCO to discharge its responsibilities anticipated under the new Insurance Law as well as to undertake a development role for the insurance sector. In the initial stage of insurance development, the insurance supervisor is expected to play the role of facilitator as well as regulator of the sector. Recently, authorities have been seeking cooperation with institutions such as the Malaysia Insurance Institute to train~~i~~ current supervisory staff and to establish an insurance training institution in Cambodia over the medium term. Capacity building must target the key staff in the Insurance Office of MEF, as well as those in the line ministries who will be involved in the enforcement and monitoring of compulsory insurance.

E. Pension System

1. Background

49. Cambodia's pension system consists of two public programs. A pension program for military personnel was established by law in 1994, and provides basic retirement and disability benefits based on years of service and other special criteria including hazardous duty. A civil servant pension program was established by sub-decree in 1997 and provides basic retirement and disability benefits based on years of service. Currently, there is no mandatory pension program for the private sector. Each private company or organization determines its own pension scheme, if any. The government has already submitted to the legislative bodies a draft Law on Social Security, which also covers public pension scheme.

50. Under the civil servant pension program, civil servants receive a retirement pension equivalent to 80 percent of their net salary, after they have accomplished at least 30 service years. Eligible civil servants with at least 20 years of service receive a retirement pension equal to 60 percent of their respective net salary. Those who have more than 20 years of service also receive a proportional annual supplementary pension of 2 percent of their net salary.

51. According to MEF, the benefits paid under the current civil servant pension system are financed from the budget. Under the civil servant pension sub-decree, all ministries and institutions submit an annual budget and statistics of civil servants about to reach retirement and those about to be placed on disability to the Ministry of Social Affairs, Labor Vocational Training

and Youth Rehabilitation and MEF. Based on these data, part of the budget is reserved to cover the retirement and disability benefits. The Ministry of Social Affairs, Labor Vocational Training and Youth Rehabilitation is also responsible for the management and monthly payment of retirement and disability benefits. A scheme for the establishment of a pension fund for the civil servant has been under discussion in MEF.

2. Constraints and Issues

52. The current pension system in Cambodia covers only civil servants and military personnel. Because pension benefits are based on a large percentage of the retirees' previous wages, the civil servant pension system suffers from a weak financial base because little or nothing is withheld from wages to cover pension benefit payments. Therefore, transfers from the Government budget are used to meet the current pension obligations.

53. Income security for retirees and old persons represents an important component of overall poverty reduction in Cambodia. Cambodia faces a number of challenges in creating a system that will ensure income security for retirees and old persons. According to the estimate of the Ministry of Planning, roughly 4 percent of Cambodia's population is over 60 years old. This figure is expected to be 6.6 percent by 2021, when the population grows from 11.4 million to more than 20 million. This increase will create increasing demand for resources to provide income security for retirees and old persons.

F. Nonbank Financial Institutions

1. Background

54. Nonbank financial institutions (NBFIs) offering lease financing, consumer credit, and housing finance have yet to be developed in Cambodia. Some commercial banks conduct limited credit card transactions and services, and hotels and some restaurants accept credit cards. However, the general public does not have access to credit cards or consumer financing from banks.

55. Under the Banking Law, banks are allowed to conduct universal banking, including lease financing. However, the law has yet to define the basic nature and scope of leasing, and the authorities have to develop detailed procedures and prudential norms to conduct the leasing business. Housing finance is unavailable because of the underdeveloped legal framework and uncertainties regarding title to land and buildings. The current title system is neither adequately organized nor reliable.

2. Constraints and Issues

56. Most impediments in the banking sector apply to the nonbanking sector. To create an enabling environment for the development of NBFIs, the Government first needs to establish a legal and regulatory framework. Since the current Banking Law adopts a universal banking orientation, the Government should start developing the nonbanking sector in the context of banking sector development. Thus, the Government may start with establishing a regulatory framework for banks to undertake nonbanking business either in the form of in-house operations or through subsidiaries.

57. Special consideration must be given to linking the development of the nonbanking sector with small and medium-sized enterprise (SME) development. Lease financing could be an

attractive alternative product for banks in an environment with inefficient infrastructure for protecting credit providers. Leasing would readily provide the functional equivalent of loans for capital equipment to SMEs. Thus, the Government may consider the leasing business as a priority in developing the nonbanking sector.

58. Other than peripheral businesses in the banking sector, development of the nonbanking sector relies critically on relevant financial markets and infrastructure. Thus, the Government needs to carefully sequence and synchronize its efforts with the development of financial markets and infrastructure.

G. Payment System

1. Background

59. In the mid-1990s, NBC established a riel-based settlement system based on an early version of the Central Banking Law (1992). The latest Central Banking Law (1996) charges NBC with overseeing the payment system, clearing, and interbank markets.[5]

60. Annual clearings have increased from 692 checks valued at KR88,577 million in 1997 to 1,234 checks valued at KR163,284 million in 2000. To date, the clearinghouse operates clearing sessions that extend into the next day. Efforts are under way to achieve same-day clearing despite concerns over banks' ability to conform to it.

61. With IMF TA, NBC has improved the rules for clearinghouse operations and has made substantial progress toward creating and regulating clearings in US dollar-denominated checks.[6] Considering the dominant use of US dollars in the economy, banks are expected to actively participate in US dollar-denominated clearings. This change will facilitate payment operations and shorten availability time. However, the effectiveness of the new regulations will depend on the compliance capacity of commercial banks and the establishment of safeguard measures for addressing emergency cases. A recent Prakas establishes a working group for addressing clearing, settlement, and payment system issues.

2. Constraints and Issues

62. Despite recent improvements, the payment system still needs further refinement to safeguard it against settlement failure. The Prakas absolves NBC from responsibility or liability for payment failures.[7] The mechanisms have not been implemented to enable NBC to extend emergency liquidity to a bank that is experiencing a temporary delay in the receipt of large payments. This should warrant a further review of how, in the event of a large payment failure, the banking system could be assured there will not be an interruption in bank operations and solvency, and that preventive measures will be in place to avert a liquidity crisis.

63. The current payment system is built on weak legal underpinnings. There is no penalty for dishonored checks, and existing laws do not address criminal charges for check fraud. There should be a minimum legal basis for the payment system through drafting a payment law that

[5] "The Central Bank may establish a clearing house for the prompt clearing and settlement of interbank payments" (Title VIII, Article 40).
[6] See Prakas on US Dollars Net Settlement Clearing House, Number B-5.00-150.P.K., November 14, 2000.
[7] See Prakas on US Dollars Net Settlement Clearing House, Number B-5.00-150.P.K., November 14, 2000, Article 18 and 19.

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

H. Interbank/Money Markets

1. Background

64. There is no recognized interbank/money market operating in Cambodia other than an occasional exchange of deposits among a few banks that trust one another. The lack of an interbank market hampers banking operations and increases operating costs. Since there is no way to manage liquidity, most banks are forced to maintain high levels of non-earning assets, incurring opportunity costs. The percentage of cash to total assets amounts to roughly 19 percent, and 33 percent of total assets are non-earning.

2. Constraints and Issues

65. Two factors hinder the establishment of interbank/money markets in Cambodia. First, the lack of mutual confidence among commercial banks hinders interbank market services. There must be a forum to build mutual confidence among banks and to discuss common policy agenda. Thus, the commercial banks first need to work together to establish an inclusive bankers association and obtain official recognition from the authorities. Second, the lack of a legal basis for money market instruments hinders the development of interbank markets. To improve the current situation, establishment of the legal basis for negotiable instruments must be a prime consideration in legislation.

I. Capital Markets

1. Background

66. Under the Prime Minister's initiative, the Government has made considerable efforts toward capital market development. The Government drafted a Capital Market Law in 1995; unfortunately, this initiative was interrupted as a result of the political disturbance in 1997. Even after 1997, only limited progress has been made because of delays in the development of related financial and legal infrastructure.

67. With the progress in governance reform assisted by ADB and the World Bank, the Government is now renewing its efforts toward capital market development. For instance, it has established a capital market unit in MEF. The Government is also drafting a subdecree to create an independent securities supervisory body responsible for attending to all of the functions of capital markets and bringing about its full operation. The main functions of the supervisory body would include (i) implementing relevant regulations, including the making of administrative rulings; (ii) supervising and safeguarding securities operations in settling and trading; and (iii) licensing and registering all entities (broker-dealers, registrars, investment companies, management companies, depositories, custodians) engaged in securities markets activities.

---

[8] IMF is considering TA to draft a payment law.

68. However, the Central Banking Law (1996) assigns NBC the responsibility for establishing and overseeing financial markets. According to this law, NBC has duties and functions to participate in the formation and supervision of the money and financial markets. In addition, the Central Banking Law empowers NBC to conduct securities operations to facilitate the registration, distribution, and trade of securities issued by the Government (Title VI, Article 23). These powers would have to be delegated by NBC to a securities and exchange commission (SEC) once it is created.

2. Constraints and Issues

69. Capital markets cannot be established and operational until accounting, legal, and other financial infrastructure is in place and the legal and accounting professions are organized and operational. Not only is it necessary to draft and pass key laws, but the implementing institutions must also be formed and developed. Furthermore, potential listing companies must be willing to accept higher standards of corporate governance and be capable of producing audited financial statements. Thus, the Government needs to conduct a feasibility study to assess a critical mass of issuers in line with the promulgation of the Law on Commercial Enterprises.

J. Legal Infrastructure

1. Background

70. Financial sector development depends on an adequate body of laws that covers contracts, bankruptcy, collateral, and loan recovery. To enforce these laws, a body of ethical and professional lawyers and judges and a reliable and efficient court system whose decisions are enforceable must be in place.

71. The civil code and procedures are being drafted with assistance from the Japan International Cooperation Agency. These laws will provide a legal basis from which stakeholders in the financial sector will obtain their rights and liabilities and their causes of action. The civil code should be drafted to ensure certainty in basic contract law principles, including rights attached to securities and the rules governing the transfer of those rights. Because these laws are yet to be put in place in Cambodia, specific legislation can supplement this deficiency.

72. The Ministry of Commerce (MOC) has submitted a draft Law on Commercial Enterprises to the Council of Ministers which is being debated and is expected to be adopted by the National Assembly by mid-2002. In May 2000, Cambodia ratified adherence to the New York Convention on commercial arbitration and is now drafting a Commercial Arbitration Procedure. MOC is also drafting a Bankruptcy Law and a Secured Transactions Law with IMF assistance.

73. The Government is moving forward with judiciary reform as an integral part of governance reform. It has adopted the Governance Action Plan, which underscores the importance of human resource development, court inspection, and infrastructure. Moreover, the Ministry of Justice has drafted a Law on the Organization and Function of Court System that includes establishment of a commercial chamber and four other chambers in the district court. The draft is under review by the Council of Ministers.

2. Constraints and Issues

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

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

K. Accounting and Auditing System

1. Background

76. Cambodia has yet to adopt common accounting and auditing standards and to establish an enforcement mechanism. MEF's Commission for Accounting Reform has endorsed the adoption of the International Accounting Standards (IAS) and International Standards on Auditing (ISA) as core principles of accounting and has submitted a draft Accounting and Auditing Law to the Council of Ministers for reconsideration.

77. Currently, the local offices of two international accounting firms, and several local firms, undertake most of the auditing services in Cambodia. The international firms together employ approximately 125 staff and serve about 400 clients, of which 30–40 percent are private companies. Many of the private companies are the local affiliates of international companies, and the audited information is sent to the home office for inclusion in the consolidated accounts.

78. At present, most senior accountants and all of the managers are expatriates. Both international firms have looked into certification of Cambodian staff using programs from the Association of Chartered Certified Accountants. Although the inspections may be taken locally, this program is very expensive because the training courses are located in Viet Nam. The demand for trained auditors is expanding rapidly and will increase dramatically once an Accounting and Auditing Law and common standards are established.

---

[9] This recommendation on the sequence of legislation is also supported by a previous ADB study on Cambodia's financial management and governance issues. The study suggests that "the current draft Capital Market law and the draft Law on Commercial Enterprises be reviewed and replaced by a comprehensive Law on companies and, at the appropriate time, a further law be drafted regarding the establishment of a securities and exchange commission and a stock exchange." See Narayan, Francis B., and Ted Gordon. 2000. *Financial Management and Governance Issues in Cambodia: Diagnostic Study of Accounting and Auditing*. Manila: Asian Development Bank.

79. NBC has a broad legal mandate to regulate nearly all issues related to the accounting and auditing of banks. This goes beyond the usual prudential regulations to include establishment of the rules for measurement, recognition, and disclosure in the financial statements, and consolidation of accounts. The Central Banking Law also permits NBC to establish accounting standards for the banking sector that are separate from the tax regulations. NBC has drafted a uniform chart of accounts for banks. Most of the accounting policies are taken verbatim from the "Framework for the Preparation and Development of Financial Statements," published in July 1989. However, there are some substantive changes, so the resulting financial statements will not be in accordance with IAS.

2. Constraints and Issues

80. Given the importance of the accounting and auditing system in Cambodia, the Government needs to expedite the promulgation of the Accounting and Auditing Law and the adoption of common accounting and auditing standards.[10] Although the Government has already committed to adopting IAS/ISA in their entirety, it should carefully work out an implementation plan to phase in IAS/ISA, considering the limited capacity of and compliance cost to the private sector.

81. The Government should play a pivotal role in establishing an enforcement system for accounting and auditing standards. Upon adopting the Accounting and Auditing Law, the Government should establish an accounting standards authority and a professional association of accountants and auditors. An association serves important regulatory functions in the public interest. In the early stages of development, an association can provide a forum for practitioners to communicate with the Government and educational institutions. An association also can communicate best practices to members and thus help to reduce the cost of providing training to staff members by combining the resources of member firms. A more mature association can assume regulatory functions, including certification of new auditors and enforcement of a code of ethics, and may offer continuing education programs. The draft Accounting and Auditing Law includes provisions for creating the National Accounting Council and an Institute of Khmer Auditors and Accountants under the aegis of MEF. The international best practice for such organizations is that they be private sector entities. However, regardless of how the division of responsibilities is determined, there is an urgent need for the establishment of such an association.

L. Human Resource Development

1. Background

82. Lack of human resource capacity is a major impediment to financial sector development in Cambodia. There is great need for formal training in core skills (such as banking, accounting, statistical analysis, and general management) and in the specialized competencies necessary for the effective operation of a market-driven economy in both the public and private sectors.

83. A number of institutions and organizations play a role in the development of human resources for the financial sector in Cambodia. These include universities and business schools,

[10] The rationale for adopting international standards is as follows: First, it is time-consuming and expensive to develop national standards. Second, it is also time-consuming for users to learn national standards in addition to IAS. Even the largest economies today are moving toward adopting IAS.

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

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

2. Constraints and Issues

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

86. Commercial banks will continue to send their employees outside of Cambodia at high cost until adequate training is available inside the country. Many commercial banks have indicated the need for a professional training program in Phnom Penh. However, the commercial banks will send their employees to training only if it is practical and relevant and taught by experienced bankers. One reason for the absence of professional training is the difficulty in hiring qualified instructors with the practical commercial banking experience necessary to teach courses such as credit analysis, letters of credit, foreign exchange, bank operations, and asset/liability management.

87. A bankers association is the logical home for a professional training program for bankers. By pooling resources and using experienced commercial bankers to teach training programs, a bankers association can be an effective means for providing training to the commercial banking sector. Upon creation of an inclusive bankers association, it should first establish such a professional training program. The training program should also be open to staff of MFIs.

III. FINANCIAL SECTOR VISION FOR 2010: “PREPARATION FOR TAKE-OFF”

A. Prospect for Economic Development under Governance Reform

88. The development of both the financial sector and the private sector depends on governance reform. Good governance is emerging as a key element to sustain social and economic development. Governance is defined as the manner in which power is exercised in the management of a country’s economic and social resources for development. One critical challenge facing Cambodia in the area of governance is to strengthen the accountability of institutions in the public sector. The necessary reforms include (i) judiciary and legal reform, (ii) public administration reform, and (iii) public finance reform.

89. An ADB study[11] on the development impact of comprehensive governance reform suggests that the Cambodian economy will be able to sustain an average annual economic

[11] Kato, Toshiyasu, Jeffrey A. Kaplan, Chan Sophal, and Real Sopheap. 2000. *Cambodia: Enhancing Governance for Sustainable Development*. Manila: Asian Development Bank.

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

90. **Judiciary/Legal Reform and the Development of Private Sector Framework.** Judicial/legal reforms provide an environment favorable to long-term and large-scale investment and create a level playing field for domestic and foreign investors. They also ensure the protection of creditors and investors and generate confidence in the future prospects of Cambodia's economy and public policy. This enables the Government to develop financial markets and help to integrate the country with the regional and world economies to improve its prospects as an industrial base for exports targeting the region and the rest of the world.

91. **Public Administration Reform.** Public administration reform consists of three components: (i) the demobilization of soldiers and security officers, (ii) the rationalization of civil administration, and (iii) an increase in the average monthly salaries of public officials.

92. **Public Finance Reform.** In public finance reform, revenue-enhancing measures increase the efficiency of tax collection. This enables the Government to increase revenues from direct taxes, indirect taxes, and customs duties. Forestry sector reform increases the Government's managerial capacity to control the volume of logging. This enables the forestry sector to be sustainable and to contribute long-term revenues to the National Treasury.

93. **Continuous Flow of Official Development Assistance.** The Government's strong commitment to reforms sends positive signals to aid agencies. This enables Cambodia to have access to grants and loans, which are necessary to carry out various reforms and development programs.

94. The "reform scenario" in the ADB study optimistically predicts that if the governance reforms are implemented on a full scale, a high level of sustainable economic growth will be achievable in the coming two decades. Major predictions under the "reform scenario" are summarized as follows:

(i) The real GDP growth rate will accelerate from 5 percent in 2000 to 7.7 percent in 2005, and will be maintained around the average annual rate of 7-8 percent from 2005 to 2020.

(ii) The GDP will triple from $3,302 million in 2000 to $10,263 million in 2010, and per capita income will increase by about two times in 10 years, from $274 in 2000 to between $500 to $650 in 2010.

(iii) Total savings and exports as percentages of GDP will increase by about 10 percentage points.

Figure 2. Expansion of the Economy

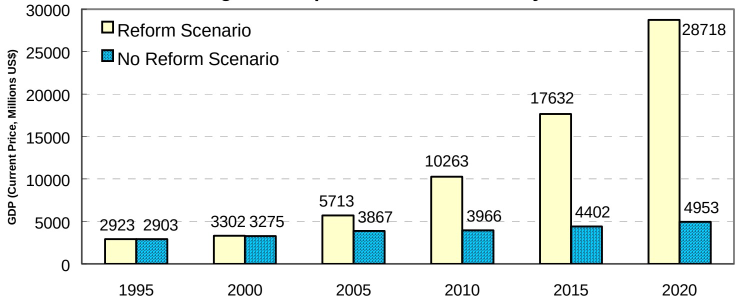


Figure 3. Per Capita GDP

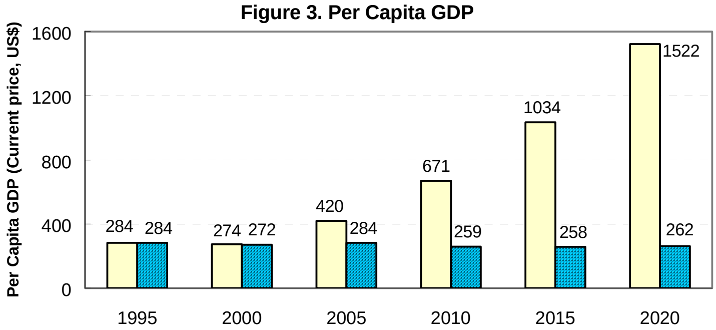


Figure 4. Exports

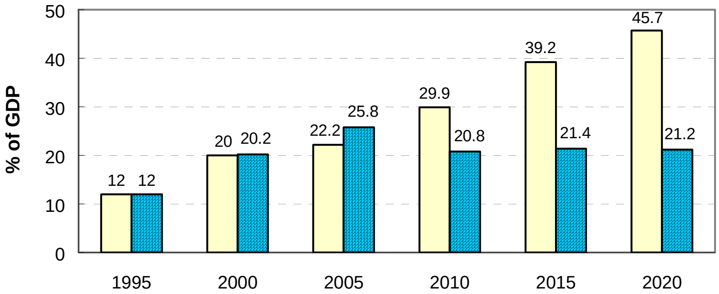
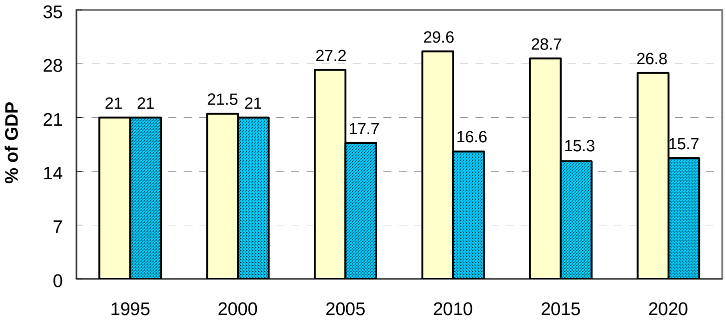


Figure 5. Total Savings

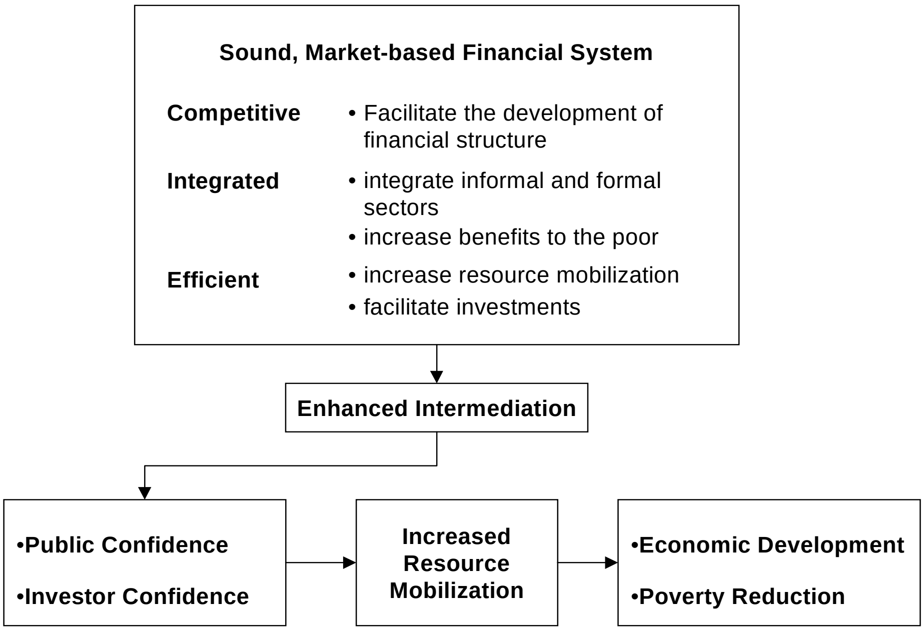


B. Financial Sector Development Vision for 2010

1. Overview

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

Figure 6: Financial Sector Vision for 2010



96. The empirical relationship between financial asset growth and economic growth shows that financial assets grow faster than per capita GDP. Moreover, the speed of financial assets growth is much faster when per capita GDP is below $1,000 (Box 1). The ratio of financial assets to GDP in Cambodia should at least triple as GDP triples and per capita GDP doubles over the next 10 years.

97. The spread between loan and deposit rates will narrow as intermediation becomes more efficient. Similar to the experience of other economies (Box 2), several factors will contribute to this trend in Cambodia and determine the speed of reduction in spread. The major contributing factors include (i) sustained macroeconomic stability, (ii) reduced uncertainties resulting from improved legal and financial infrastructure, and (iii) increased competition among banks.

Box 1: Financial Interrelation Ratio

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

Figure B1.1. FIR: 1965-90

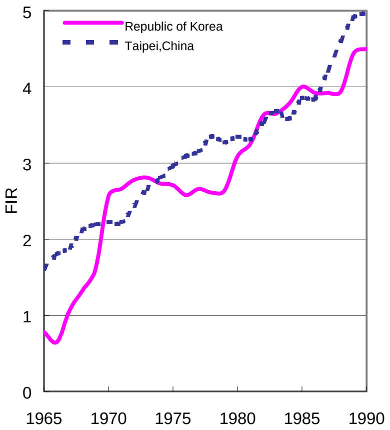
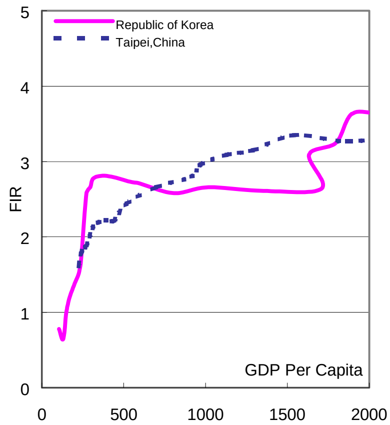


Figure B1.2. FIR vs. GDP Per Capita



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

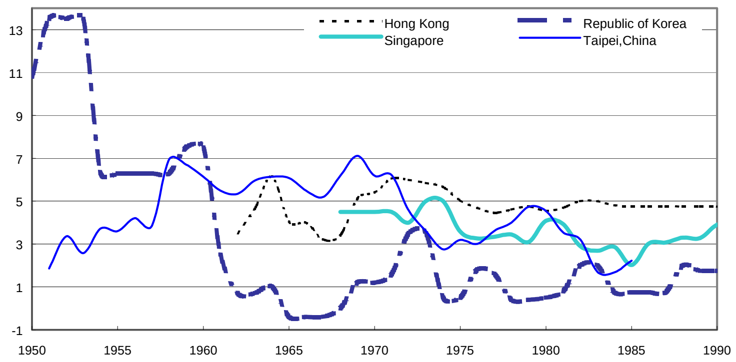
The figures show that financial assets grow faster than per capita GDP in the course of economic development. Furthermore, the speed of growth of financial assets is much faster when per capita GDP is below $1,000. Once the economy attains a certain stage of development, the FIR ratio tends to level off.

In the case of the Republic of Korea, when GDP tripled from $3 billion to $9.73 billion and per capita GDP tripled from $105 to $296 during 1965-1971, FIR jumped from 0.78 to 2.66, meaning that the total financial assets become more than 11 times those at the beginning of the period. The number for Taipei,China is less dramatic but still very significant. During 1966 and 1973, its GDP also tripled from $3.13 billion to $10.77 billion and the per capita GDP doubled from $242 to $700, with financial assets increasing more than fivefold as FIR increased from 1.8 to 2.66.

Box 2: Interest Rate Spread

The historical data of the four Asian Tigers illustrate the relationship between interest rate spreads and depth of financial system.

Figure B2.1. Spread of Loan and Deposit Interest Rates



Spreads consist of operating costs and a risk premium. Operating costs include treasury costs, salaries, and other administrative expenses of the banks, while risk premiums cover legal, regulatory, and other uncertainties.

The right environment is the key for developing the financial system and for reducing interest rate spreads. With the deepening of the financial system, the competition among financial institutions will increase the financial intermediation efficiency and in turn bring down spreads.

The data show that interest spreads tightened over the observed period, reflecting increased intermediation efficiency. Taipei,China's case differs in the early years, when the government controlled the interest rates. After relaxation of interest rate control, the spread also followed the generally declining trend. The Republic of Korea's spread was above 13 percent during the Korean War period, and a speedy reduction in spread followed thereafter. With the liberalization of interest rates, strong competition among banks resulted in negative spreads for about three years during the mid-1960s.

The current interest rate spread in Cambodia is above 13 percent per annum, reflecting the lack of liquidity management instruments, lack of law and contract enforcement mechanisms, and heavy adverse selection on the borrowers' side. Once these issues are resolved, Cambodia can expect a decline in interest rate spreads. First, efficient interbank markets will substantially reduce the operating costs of banks. Second, with introduction of the rule of law and a contract enforcement mechanism, the costs related to legal uncertainties will decline. Third, with the development of accounting and auditing standards and monitoring systems, the uncertainty with regard to borrowers will be minimized and thus reduce adverse selection.

98. The banking sector will be the prime area of growth in financial assets, followed by the insurance sector. This projection is based on factors such as (i) the current structure in which banks are predominant, (ii) enhanced intermediation capacity following a comprehensive bank restructuring under the IMF Poverty Reduction and Growth Facility program, and (iii) improved financial infrastructure. Universal banking orientation under the Banking Law will further strengthen the leading role of banks over the medium term. In fact, the banking sector has demonstrated its capacity to increase the loan portfolio by more than 30 percent over the last two years with the increased demand from the real sector. With the successful restructuring assisted by IMF, the banking sector will step up its capital base. Further, the banking sector will increase intermediation capacity once related infrastructure is developed.

2. Development of Financial Institutions

99. **Expansion of the Banking Sector**. Competition between banks will facilitate reorganization of the banking industry, resulting in economies of scale and scope as some of the best performing banks acquire or merge with other banks. Some weaker and perhaps smaller banks may voluntarily decide to sell to or merge with stronger performing banks. The strategy of being acquired or merging with stronger banks will improve the efficiency of the banking system through better utilization of bank capital and human resources, as well as sharing common resources across a broader product line.

100. As competition among commercial banks increases, banks will become less dominant, as a more balanced and integrated financial structure with diverse nonbank financial activities gradually emerges. Competition may drive banks to adopt different strategies for expanding into the nonbank financial business. Given a universal banking system, some of the best performing banks will expand the scope of their businesses into nonbank areas as they increase their capital bases and assets through mergers and acquisitions. Others will decide to specialize in either commercial banking or non-bank finance, which will separate banking and nonbanking activities. As the number of banks that adopt specialized financial services increases, so will the diversity of nonbank financial institutions.

101. As banking efficiency improves, the scope of bank products will expand to include diverse maturity profiles and interest rate structures. In the short term, reduced uncertainties in the legal environment will enable banks to increase the average maturity of loan products and to reduce loan-deposit interest rate spreads. Furthermore, the improvement in the payment system and the availability of diverse negotiable instruments will permit the banking sector to further expand payment services. Competition between banks will lead to increased investments in information technology (IT) and attract new customers. An improved IT environment will expedite the development of credit cards and other consumer finance services.

102. With the Government’s proactive privatization efforts and market-oriented reform, the banking sector will be dominated by privately owned banks. The universal banking orientation in the Banking Law will limit state ownership in the banking system because the private banking system is expected to undertake the major role of development financing.

103. The non-agriculture sector will remain the dominant borrower in the banking system. The service and manufacturing industries will lead the growth of bank loan portfolios. The banking sector will become a major financing source for the working capital of SMEs and microenterprises. With improvement in transparency, a growing number of banks will lend based on cash flow analysis rather than on the availability of collateral, which will thereby improve the quality of loan portfolios.

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

105. With the promotion of the financial service outreach as well as the development of financial infrastructure, a variety of community-based savings institutions such as cooperatives, credit unions, and postal savings offices will emerge. These second-layer savings institutions will supplement the banking system because they will provide additional rural lending and diversify channels for banking and payment services among the lower income classes and the rural areas.

106. **Rural Finance.** The development and reorganization of the banking industry will enable expansion of the banking network in rural areas. This will enhance the access of farmers and rural businesses to financial services and serve to integrate the rural and urban financial markets. The agriculture sector, in particular, will be able to access long-term resources. With the policy, legal, and institutional measures initiated for microfinance development, an array of MFIs is likely to emerge to provide a range of financial services to the poor. NGOs with substantive long-term interest in microfinance will graduate to licensed MFIs. Strengthening of regulatory and supervisory systems, information systems, and accounting and auditing standards will improve the capacity of MFIs and enable them to leverage funds in the market and provide competition.

107. **Emergence of NBFIs**. Given the current bank-dominant structure, it is probable that NBFIs will emerge as subsidiaries of banks. Leasing companies and consumer finance companies will be the first possible candidates for NBFIs in the form of subsidiaries of commercial banks. In the initial stage, the securities trading business also will be undertaken by the commercial banks directly or on behalf of clients. As business expands in the securities market, risk management concerns will facilitate the separation of the banking and securities businesses.

108. The improved legal framework and the development of money markets will facilitate the emergence of money market intermediaries such as finance and investment companies. The development of capital markets will also bring diverse capital market intermediaries and institutional investors such as securities companies, investment and trust companies, and venture capital companies.

109. **Development of the Insurance Sector and Pension System**. With the strengthened efforts to privatization, the insurance sector will be soon transformed into a market-oriented system where the private sector dominates. Given the weak demand, the current oligopolistic structure will be sustained over the medium term. In the initial stage, nonlife insurance companies will dominate the insurance market to meet the increasing demand from the business sector. Implementation of compulsory insurance policies will give impetus to the development of the nonlife insurance business by creating policy-driven demand. Further, with the promulgation of supporting laws and the development of enforcement/monitoring mechanisms, compulsory insurance will create a broader demand base for the insurance business. Third-party liability motor insurance will first emerge after the appropriate legislation and enforcement. With the expansion of commercial activities and the increased awareness of insurance in the business sector, the insurance sector will further diversify its products to

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

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

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

3. Development of Financial Markets and Instruments

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

113. **Interbank/Money Markets.** Development of interbank markets will enable financial institutions to manage liquidity more efficiently and reduce operating costs. With a gradual build-up of confidence among commercial banks, unsecured overnight interbank borrowing among a small number of large banks will emerge first. With the availability of Treasury Bills (T-Bills) and other government securities, repurchase agreements will further expand the scope of interbank markets. Under the guidance of the central bank, the Bankers Association will play a catalytic role in developing and deepening interbank markets' architecture and services.

114. With the increased sophistication of fiscal management, the Government will issue T-Bills and further diversify the maturity structure of its securities. Interest rates on government securities will play a key role in setting benchmark interest rates for pricing marketable financial instruments. Thus, the development and deepening of government securities market will create a positive environment for diverse money market instruments as well as a market-based monetary policy through open market operations.

115. In the early stages of money market development, commercial banks will take the lead in issuing money market products such as negotiable certificates of deposits and will play the role of intermediary as well. With the development of the export-import industry, trade bills will also emerge. The introduction of commercial papers and corporate bonds may come at a much later stage.

116. With the strengthening of the legal infrastructure, especially the adoption of a negotiable instruments law, basic negotiable instruments such as commercial bills, bills of exchange, and

promissory notes will emerge. Increased commercial activities and enhanced financial intermediation will facilitate the use of negotiable instruments issued by financial institutions, which in turn will reduce transaction costs in the economy as a whole.

117. **Capital Markets.** The foundation for capital markets will be in place within the next 10 years. Public confidence in the financial and corporate sectors will improve substantially. Successful reform in the judiciary system and enforcement of key laws such as the company law, contract law, and bankruptcy procedure will enhance the rule of law. The promulgation of the Accounting and Auditing Law and the implementation of IAS/ISA as common accounting and auditing standards will strengthen public confidence in the corporate sector. Continued macroeconomic stability and the Government's de-dollarization policy will boost public confidence in riel-denominated assets. Together with improved transparency in the corporate sector, these measures will build a solid demand base for corporate securities. A critical mass of issuers will emerge as economic growth gains momentum under improved transparency.

118. Until an SEC is established and the related securities market infrastructure is in place, corporate securities will be initially traded on the over-the-counter market. With the development of government securities, fixed income securities of large public corporations may emerge on the over-the-counter market. As the number of qualified issuers increases, a securities exchange will be established.

119. The commercial banks will play the role of intermediary in the early stage of capital market development. When the securities exchange market is formally operating, securities companies will emerge as subsidiaries of larger and more active commercial banks. Foreign securities companies may also show interest and open branches in Cambodia.

120. Some contributing factors include (i) macroeconomic stability, (ii) the Government's de-dollarization policy, (iii) a gradual recovery of public confidence, (iv) development of the legal and financial infrastructure (such as promulgation of a company law and a bankruptcy law), (v) emergence of a critical mass of issuers, (vi) buildup of an investor base and income level, (vii) institutional capacity of a regulatory body, and (viii) availability of human resources.

4. Regulatory/Supervisory System and Financial Safety Net

a. Regulatory and Supervisory Structure

121. The regulatory and supervisory system will be developed to encourage competition among the financial institutions while safeguarding the integrity of the financial system. Continuous modernization of prudential regulations based on international best practices will improve transparency and predictability and thus reduce the compliance cost of financial institutions while instilling market discipline.

122. NBC will pursue a medium-term reorganization plan to establish itself as an independent regulator with full-fledged supervisory capacity. It will be able to allocate adequate resources for staffing, training, and compensation to attract and retain qualified staff. Its supervisory functions will improve with the development of prudential norms, improvement in the accounting infrastructure, and enhancement of human capacity. As banking activities increase and diversify, NBC will continue to increase supervisory resources and improve supervision skills, so BSD will be a major functional body in the central bank over the next 10 years.

123. NBC will also maintain its functional independence when conducting monetary policy. With the development of money markets and the availability of diverse financial instruments, monetary policy function will be enhanced, thus strengthening NBC's role as the lender of last resort.

124. MEF will become a key policy initiator of the financial system as it will establish the regulatory system in nonbanking areas, including insurance. MEF also will be responsible for the laws related to the financial infrastructure. In the first phase, insurance supervision will be strengthened through further enhancement of the capacity of the Insurance Office of MEF. As the insurance sector expands in respect of institutions and products, an independent insurance supervisory authority will be established.

125. With the promulgation of a securities and exchange law, an SEC will be established as the primary supervisor of capital market activities. In the initial stage of capital market development, NBC will oversee the securities business of commercial banks, which will be major players in securities trading on the OTC market.

126. With the establishment of sector-specific supervisors, coordination among supervisors will become critical to maintain consistency and to avoid conflicts. Therefore, the coordination role of MEF will become more significant. The Government may decide to establish a coordination committee to maintain the integrity and consistency of supervisory policies while honoring the independent activities of supervisors.

b. Financial Market Safety Net

127. As each supervisory authority puts in place a prompt corrective mechanism for each sector based on international best practices, the financial market safety nets will improve. As financial activities expand, explicit financial market safety nets will also be established in the form of a sector-wide deposit insurance system. A deposit insurance system will be first introduced in the banking sector. The safety nets will be designed to avoid the moral hazard problem and will target especially the protection of small depositors. Equally important is the financial sustainability of the safety nets, which will be achieved partly through an equitable share of burdens among participants.

5. Financial Market Infrastructure

a. Legal Infrastructure

128. The basic legal infrastructure that will underpin the financial system and commercial activities will be in place. The ultimate goal of legal/judiciary reform will target (i) well-defined property rights; (ii) enforceable contracts; (iii) ability to pledge and seize collateral; and (iv) fiduciary responsibilities and liabilities of financial agents, stakeholders, and managers of financial institutions. For this, a comprehensive civil code, following commercial contract law and procedures, will be in place. In addition, a complete commercial code will be implemented after the adoption of the Law on Commercial Enterprises, a bankruptcy law, etc.

129. With successful judiciary reform, law enforcement will be strengthened. In particular, a commercial chamber of the court will play a key role in reestablishing public confidence in the judiciary and law enforcement systems.

130. A secured transactions law and a public registry system will be in place, which will reduce transaction costs by alleviating uncertainties about secured transactions and collateral registration. With the promulgation of the supporting laws, a public registry for movables will be in place.

131. The development of the legal infrastructure and improved public confidence will reduce uncertainties regarding contract enforcement, which will facilitate private sector development by revitalizing commercial activities and financial transactions. More important, reduced uncertainties of contract enforcement will substantially reduce the transaction and operating costs of the financial institutions and thus facilitate intermediation.

b. Accounting and Auditing System

132. With the Government's proactive policy, the accounting and auditing system will be developed based on international standards. Financial and nonfinancial public corporations will take the lead in adopting IAS/ISA, which will be followed by private companies.

133. The establishment of an association of accountants and auditors will improve the enforcement of accounting and auditing standards. The association will play a key role in developing the accounting industry, as well as in capacity building, by providing professional training in accounting and auditing.

134. Improved transparency resulting from strengthened enforcement of auditing and disclosure standards will enhance public confidence in financial institutions. The banking sector will be the first group of beneficiaries when improved transparency in the corporate sector will reduce information costs. Improved transparency will also facilitate the development of the nonbanking sector and capital markets.

c. Financial Market Information System

135. An efficient and reliable credit bureau or arrangements for sharing credit information will allow financial institutions to timely access to credit information. This will be complemented by improved transparency in the corporate sector because of strengthened enforcement of accounting and auditing standards. Furthermore, a credit rating agency will emerge as the issuance of corporate securities and commercial papers increases. Improved quality of the financial information infrastructure will reduce the information costs of financial institutions.

d. Payment System

136. An efficient payment system will be established to settle funds between customers and banks, and among financial institutions. An increased investment in IT by both the private and public sectors will enhance the efficiency and quality of the payment system. Integration of computer networks and adoption of on-line banking systems will further improve the payment system; diversify payment instruments for prompt noncash fund transfers; and facilitate integration of the formal and informal sectors, thus increasing the viability of financial institutions in the rural area.

6. Capacity-Building Mechanism

137. The capacity-building institutions, in both the private and public sectors, will be in place to meet the multifaceted demands of the financial system. The Bankers Association will take the

lead in major capacity-building activities in the private sector. The collective efforts of commercial bankers under the Bankers Association will provide professional training through international cooperation and the establishment of a bankers' training institute. Capacity building in the public sector will be accomplished through the establishment of self-funded training institutions and the continuous reorganization of key regulatory institutions.

IV. FINANCIAL SECTOR BLUEPRINT

A. Introduction

1. Structure of the Blueprint

138. The Blueprint comprises a long-term development strategy and a sector development plan. 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 plan.

139. Each sector development plan consists of a development goal, intermediate reform agenda, and illustrative policy measures in each phase. The development goal describes the sector strategy to achieve visions in each sector over three phases: 2001-2004, 2005-2007, and 2008-2010.

140. The intermediate reform agenda is selected to help (i) identify specific policy measures to achieve the goals that have been set, and (ii) sequence and pace these policy measures. In other words, the intermediate reform agenda in a specific phase describes *tactics* to achieve the set goals. At the same time, a series of reforms over three phases suggest sequencing tactics for development efforts in a specific subsector. 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 intermediate 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.

141. The sector development plan is a *think panel* to assist policy makers and stakeholders in sequencing and coordinating development efforts. The panel considers the interrelation of (i) human and institutional capacity building, (ii) the development of related infrastructure, (iii) the establishment of a legal and regulatory framework, (iv) the emergence of relevant financial markets, and (v) the availability of technology.

142. 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 Blueprint also focuses on the institutional and human capacity building needed to implement measures that address financial sector weaknesses.

143. The sector development strategy is a rolling plan that needs continuous updating to reflect the Government’s achievements and the changing socioeconomic environment. If the

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

2. Long-term Development Strategy

144. A long-term development strategy is developed to implement the financial sector vision, which has been derived from the following factors: (i) key lessons drawn from other economies' experiences with financial sector development, (ii) the current situation in Cambodian financial markets, and (iii) the progress in governance reforms under implementation.

145. 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 (i) a sound and sustainable macroeconomic environment; (ii) sound governance, including legal and accounting infrastructure; (iii) effective market discipline; (iv) adequate institutional and human resource capacity; and (v) the ability to take advantage of modern technology.

146. In particular, the development of the banking system builds on an adequate body of laws that underpin the financial system and transactions, covering contracts, bankruptcy, collateral, and loan recovery. Supporting the body of laws must be ethical and professional lawyers and judges and an efficient court system whose decisions are enforceable. In addition, financial reporting must be based on common accounting and auditing standards so that investors and supervisors can assess the financial condition of the banks, and banks can monitor the health of the institutions to which they lend. Accurate financial data require a professional body of accountants and auditors.

147. The initial stages of the Blueprint focus on building sound governance through developing the legal and accounting infrastructure, and building institutional and human capacity. An early focus is given to banking sector development, as this has proven to be the fastest means of mobilizing financing for private sector growth in developing economies. Next, to lay the foundation for capital market development and contractual savings, the Government must develop proper legal and supervisory frameworks.

148. 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 for the Blueprint, the following 10 key lessons are noteworthy:

(i) A sound fiscal policy and price stability are the preconditions for a well-functioning financial system.

(ii) The financial sector will not develop without public confidence in the protection and security of property rights and contract enforcement.

(iii) A sound financial sector cannot be created without establishing the rule of law, supported by an appropriate legal/judiciary system and law enforcement.

(iv) 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.

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

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

(vii) State ownership of financial institutions and state intervention in the allocation of financial resources hinder the development of a market-based financial sector.

(viii) Strict entry regulation in financial industries is one factor that adversely affects financial development and the allocational efficiency of investment funds.

(ix) Lax entry requirements under a weak supervisory system results in an excessive number of poorly managed banks.

(x) 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.

149. Based on the above lessons, the key elements of a long-term strategy for financial sector development are as follows:

(i) maintaining sound fiscal and monetary policies to ensure macroeconomic stability;

(ii) systematically establishing a sound legal framework to protect property rights and enforce contracts;

(iii) establishing the rule of law through legal/judicial reform and law enforcement to underpin financial and commercial activities;

(iv) sequencing efforts to develop financial infrastructure, particularly the payment/clearing system, accounting and auditing system, credit information system, and regulatory framework;

(v) 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;

(vi) 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;

(vii) establishing a sound framework for private sector development in the financial system by phasing out state ownership and state intervention in the system;

(viii) developing a transparent entry framework to encourage allocational efficiency and financial deepening;

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

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

B. The Banking Sector

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

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

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

(i) establishing a basic framework for monetary policy,

(ii) establishing a framework for supervision,

(iii) restructuring the banking sector,

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

(v) establishing a capacity-building mechanism.

152. **Establishing a Basic Framework for Monetary Policy**. It is imperative that monetary policy be normalized to safeguard macroeconomic stability. Considering the rampant dollarization in the economy, a full-fledged monetary policy is not expected to be in place until Phase III. However, the basic preparatory work to establish monetary policy framework should be initiated in Phase I. The following steps should be considered: (i) streamlining reserve requirements to reduce idle bank reserves and reduce commercial banks' operating costs, (ii) phasing out the guarantee deposit or capital reserve required for bank licensing, and (iii) considering reducing the reserve requirement ratio on riel-denominated deposits. A lower reserve requirement for riel-denominated deposits would help increase the attractiveness of riel deposits and encourage riel-based operations among commercial banks.[12] Second, the Government should consider issuing government securities, notably T-Bills. The provision of riel-denominated securities will stimulate demand for the riel and develop banking activity in the local currency. Furthermore, the auction of T-Bills will provide benchmark interest rates on riel-denominated financial instruments. This measure will be the first step in developing an

[12] Cardona, Michel and Luca Papi. 1997. *Cambodia: Financial Sector Issues*. World Bank.

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

153. **Establishing a Framework for Supervision.** In continuation of the current efforts, NBC needs to establish the framework for effective bank supervision. Key policy actions considered include:

~~(ii)~~(i) establishing a complete body of prudential regulations by reconciling old regulations with new regulations and issuing clarifying guidance to commercial banks;

~~(iii)~~(ii) adopting surveillance and inspection procedures, including standardization of the reports submitted by commercial banks;

~~(v)~~(iii) improving the application of the CAMEL system for evaluating bank performance;

~~(vi)~~(iv) adopting new prudential regulations on lending to connected or related parties, risk management, and internal control;

~~(vii)~~(v) establishing a fully staffed on-site inspection unit;

(vi) adopting a uniform chart of bank accounts and disclosure rules consistent with IAS/ISA;

(vii) adopting a prompt corrective action (PCA) system; and

(viii) adopting an antimoney-laundering regulation.

154. **Restructuring the Banking Sector.** NBC needs to complete the bank relicensing program under the IMF program. To this end, the following actions need to be taken: First, NBC needs to establish procedures to ensure the orderly resolution and liquidation of problem banks. Second, NBC needs to make an effort to appoint liquidators for all delicensed banks as soon as possible. Third, NBC must have a contingency plan to address circumstances wherein some conditionally licensed banks are unable to achieve the conditions imposed in their memoranda of understanding to increase capital to the minimum level required under the regulations by the end of 2001. NBC should also complete restructuring and privatization of FTB in the first phase. FTB restructuring/privatization calls for many challenging tasks. First, FTB needs to adopt and implement a privatization plan. Second, the FTB board needs to adopt a business plan for the medium term to reorganize FTB as a commercial bank. Third, FTB needs to adopt a comprehensive training program to instill commercial orientation, including accounting, risk management, asset/liability management, and management information systems.

155. **Establishing a Framework for the Payment System**. Despite NBC's active efforts, the current payment system calls for further refinements. The following actions should be taken: (i) improve operational procedures for both the riel and dollar clearing systems, considering the compliance capability of commercial banks; (ii) adopt a payment law to underpin the payment system; and (iii) improve the backup system for smooth operation of the payment system. In addition, NBC and the Bankers Association should adopt a protocol for an on-line banking system to facilitate the integration of individual banks' systems in the future. Some commercial

[13] *ibid*.

Formatted: Bullets and Numbering

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

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

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

(ii) establishing a central banking course for NBC professional staff in CBS;

(iii) adopting a comprehensive retraining program for NBC staff with noncollege-level education in the form of a NBC personnel regulation;

(iv) adopting a mandatory training program for entry-level professional staff in CBS; and

(v) adopting a competitive, merit-based compensation scheme.

2. Phase II: Enhance Intermediation through Competition

157. The second phase of banking sector development aims at enhancing intermediation through competition. Competition will increase the diversification of banking services as well as the expansion of service areas, leading to increased outreach to the poor and to rural areas. This development goal in the second phase can be achieved through the following intermediate reform agenda:

(i) improving monetary policy instruments,

(ii) improving the enforcement of prudential regulations,

(iii) enhancing banking services through diversification,

(iv) improving the efficiency of the payment system through investments in IT,

(v) promoting outreach to rural areas by encouraging the establishment of branches, and

(vi) strengthening NBC organizational structure.

158. **Improving Monetary Policy Instruments**. Building on the achievements of the first phase, NBC needs to further improve the monetary policy framework. NBC may need to adopt a phased plan for further reduction of the reserve requirements. NBC also needs to prepare a detailed plan to implement rediscount/refinance facilities, because the Government is expected to regularize the issuance of T-Bills and to improve the trading system by developing primary dealerships in Phase II.

159. **Improving the Enforcement of Prudential Regulations.** Following the efforts to set up a basic supervision framework, NBC needs to improve the enforcement of prudential regulations and to continue updating regulations to reflect changes in banking businesses. The main emphasis should be on the following areas: First, NBC needs to strengthen the implementation of PCA to encourage sound management and operations. Second, NBC needs to begin full on-site inspection with NBC staff. Third, in line with strengthening PCA, NBC needs to establish a transparent exit mechanism and streamline exit procedures to allow the swift and orderly exit of nonviable banks. To do this, NBC should pursue the following:

(i) ~~revisie~~revising laws that cover insolvency and liquidation of banks to eliminate inconsistencies, and

(ii) establishing procedures for mergers and acquisitions and purchase and assumption for problem banks.

160. Finally, NBC should establish legal protection for supervisors against lawsuits for actions taken in fulfilling their official duties. Such legal protection will be the basis for proactive supervisory activities.

161. **Enhancing Banking Services through Diversification**. The Government should further enhance intermediation through the diversification of banking services. This will be achieved, in part, by allowing banks to expand their scope of business into nonbanking areas. Meanwhile, the Government needs to allow banks to set up nonbanking subsidiaries by establishing proper regulatory guidelines. To do this, NBC needs to establish a regulatory framework for credit card services, housing/mortgage finance, installment finance, etc.

162. **Improving the Efficiency of the Payment System through Investments in IT**. As financial transactions increase and become more diverse, the banking system needs increased investment in IT to improve the efficiency of the payment system. Key areas to be addressed include (i) establishment of a central bank wire system, (ii) automation of the clearinghouse, and (iii) establishment of an on-line banking system in individual banks. NBC and the Bankers Association should make concerted efforts toward the success of these tasks.

163. **Promoting Outreach to Rural Areas by Encouraging the Establishment of Branches.** This can be done through expansion of the formal banking sector to rural areas. This process will be facilitated by the Government's proactive effort, such as the introduction of an explicit incentive system for banks that are active in branching out to rural areas.

164. **Strengthening NBC Organizational Structure**. Although the key capacity-building activities for the central bank identified in Phase I will continue in the second phase, NBC must strengthen its organizational structure to undertake its increasing role and responsibilities in the financial sector. The reorganization of NBC must address a proper division of responsibilities among departments to carry out central bank functions with the evolution of the financial sector. This includes (i) defining the necessary skill mix, (ii) refining job descriptions for senior officials and professional staff, and (iii) identifying additional capacity-building requirements. The task will be initiated by a diagnostic review of the current organization and by drafting a reorganization plan. The reorganization plan should also address (i) the establishment of an effective recruitment system to attract competent staff into the central bank, and (ii) the introduction of a performance-based compensation and promotion system to retain and develop qualified staff. Reorganization requires the strong commitment and support of executive management and consensus among staff.

3. Phase III: Promote Efficiency through Integration and Reorganization

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

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

(ii) upgrading prudential regulations,

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

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

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

(vi) enhancing central bank independence.

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

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

168. **Facilitating Bank Reorganization through Incentives and a Reinforced Supervision System**. The main task of bank supervision in Phase III is to promote the reorganization of the banking sector. To this end, NBC first needs to strengthen the enforcement of PCA. Second, NBC should strengthen the incentive system by expanding the scope of nonbanking business for commercial banks that initiate voluntary mergers and acquisitions. Third, NBC needs to further refine the minimum capital requirement reflecting the increased size and scope of business. NBC might consider adopting multi-tier minimum capital requirements, depending on the business scope of the commercial banks.

169. **Establishing an Integrated On-Line Interbank System**. Automation of banking operations will continue in the third phase. The target of the third phase is to establish an on-line interbank system that integrates the central bank wire system and individual banks' on-line banking networks. With the establishment of intrabank and interbank on-line systems, the scope of banking services will be further expanded.

170. **Strengthening Outreach Rural Areas Through Competition**. The Government should promote the expansion of the formal banking sector by promoting the establishment of community-based savings institutions such as credit unions and cooperatives. To do this, the

Government must establish legal and regulatory frameworks for credit unions and cooperatives with appropriate incentive systems. Together with the integrated on-line banking and interbank system, community-based savings institutions will create competition in the rural banking sector, thus leading to further integration of the banking system, and will improve the quality of banking services in rural areas.

171. **Enhancing Central Bank Independence**. Building on the reform efforts in the second phase, NBC will be ready to undertake the modernization of its function as an independent central bank. The Central Banking Law and the Banking Law need to be revised to step up NBC's responsibilities in monetary policy and financial sector development. The independence of the central bank is essential in Cambodia, as an independent central bank will be able to safeguard the stability of the banking system and continue banking sector development in the changing sociopolitical conditions.

C. Rural Finance

172. The need for institutional development in the nascent and fragile financial sector is pervasive, and the magnitude of required support is enormous. A defined focus on the poor, especially women, the disabled, and other excluded sections is critical for creating financial and social capital in Cambodia. Access to financial services, limited as it is, has enabled the poor to participate in economic activities at the community/village levels. The Rural Credit Policy, accordingly, aims to enhance the outreach of sustainable finance through private sector participation, community-based approaches, and linkages among institutions based on competitive advantages.

173. The aim of the long-term development strategy is to enhance outreach to the poor, to low-income households, and to their microenterprises through appropriately managed institutions. Measures in Phase I aim primarily to implement the ADB-funded Rural Savings and Credit Project and TA for Rural Financial Services to provide the foundation for a sustainable rural financial system. During Phases II and III, the emphasis will be on enhancing the impact and outreach of poverty reduction. These interventions should also be sequenced with other reform agenda in the Blueprint.

1. Phase I: Implement a Basic Policy and Institutional Framework for the Rural Finance Sector

174. To achieve the goal of Phase I, the ongoing ADB-funded Rural Savings and Credit Project and the TA will continue its support to (i) implementing the policy actions specified in the Rural Credit Policy; (ii) strengthening supervision and regulation; (iii) facilitating institutional transformation, linkages, and service delivery; and (iv) building sustainable institutions. In addition, the agenda will include capacity building for optimal utilization of financial services.

175. **Implementing Policy Actions in the Rural Credit Policy.** The Government and NBC have already initiated actions pursuant to the adoption of the Rural Credit Policy. The application of the Banking Law with specific reference to licensing of MFIs needs to be broadened, as the establishment of the policy forum to facilitate stakeholder consultation needs to be expedited.

176. **Strengthening Supervision and Regulation.** The key variable in the orderly and systematic development of rural finance is effective supervision and regulation. Consistent with efforts in this regard for the banking sector, MSD of NBC needs to enhance its supervisory and

regulatory capacity, ideally ahead of the licensing of NGOs as licensed MFIs. In its supervisory and regulatory role, NBC needs to provide flexibility and room for innovation for licensed MFIs.

177. **Facilitating Institutional Transformation, Linkages, and Service Delivery.** Transformation of the six identified NGOs[14] into licensed MFIs will enable them to provide a range of services and access refinance assistance from RDB. The framework of delivery of microfinance services in Cambodia is through community groups. Funding agencies and the Government need to assist these groups to become effective intermediaries and be able to establish linkages with MFIs. Promotion of savings through MFIs will be a first step to address the demand from the poor for saving services.

178. **Building Sustainable Institutions.** To start, there is need to strengthen RDB to enable it to effectively function as a sustainable apex institution. Building the institutional capacity of the NGOs that have become licensed MFIs is critical for their sustainability. Although NBC needs capacity on many fronts, its supervisory and regulatory capacity with reference to the rural financial system is a priority. The immediate capacity-building need will be ~~accomodated~~accommodated by the existing facilities of CBS, but there may be a need to set up specialized rural and microfinance training institutions and resource centers. Possibilities for these will be explored during Phase I.

179. **Capacity Building for Optimal Utilization of Financial Services.** Demand for microfinance services for the poor is accompanied by the need for social mobilization and capacity building. These needs are more acute for those in resource-poor areas because they remain unserved or underserved due to risk-return considerations, although the social returns to reaching these clients may be high. Support is therefore required to meet the intermediation and capacity-building costs of the poor in order to build social capital. The Government will have to coordinate with planned aid initiatives and continue directing resources towards the social sector to enhance the effectiveness of microfinance.

2. Phase II: Increase the Impact of Poverty-Reduction Measures

180. To reach the goal, the agenda for Phase II includes (i) policy coordination, (ii) improving in the application of prudential regulations, (iii) establishing a range of service providers, (iv) expanding the institutional network, (v) enhancing effective intermediation, (vi) ~~promottion~~promoting innovative microfinance pilot projects, and (vii) introducing safety nets to reduce vulnerability.

181. **Policy Coordination.** It would be worthwhile to review the Rural Credit Policy to provide improved synergy with the basic financial sector building blocks that have taken shape during Phase I. To enhance the developmental impact, the Rural Credit Policy will have to be closely coordinated with investments in agriculture and rural development such as rural infrastructure, irrigation, agricultural research, and extension. The Government will need to maintain public investment priorities in the rural sector and continue nondiscriminatory agricultural pricing policies.

[14] By Loan CAM 30237: Rural Credit and Savings Project: ACLEDA, ~~Cambodia Community Building,~~ Hattha Kaksekar, Ennatien Moulethan Tchonnebat, ~~and~~ village banks organized by Catholic Relief Services, Cambodia Community Building, and Action Nord Sud. The first two are already functioning as licensed MFIs.

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

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

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

185. **Enhancing Effective Intermediation.** Building the capacity of restructured commercial banks to downscale their operations for banking with the poor and extending agricultural credit is required if these are to become active and effective participants. Similarly, intensive capacity-building support will be required for licensed MFIs for institutional and financial sustainability. Specialized training institutions and/or programs therefore will have to be established to provide affordable capacity-building services for (i) social organization, (ii) cost-effective targeting, (iii) products and services development, (iv) management information and accounting systems, (v) governance, (vi) cost-reduction technologies, and (vii) appraisal and management of term financing for agriculture.

186. **Promoting Innovative Pilot Microfinance Projects.** The Government will consider initiating innovative programs and developing financial technology and services that contribute to breaking the barriers to accessibility through pilot projects for disadvantaged groups and those living in the resource-poor areas.

187. **Introducing Safety Nets to Reduce Risks and Vulnerability.** The disadvantages of poor households include lack of access to financial services, unfair terms of participation in the local economy, and vulnerability to economic and physical downturns. As a result, poor households forgo potentially viable new technologies, production choices, and income opportunities because of risk aversion. A risk-mitigation facility that effectively targets the poor is not available. Insurance services will be extended to the poor during Phase II to mitigate some of the risks.

3. Phase III: Enhance Sustainable Outreach

188. The agenda for Phase III includes (i) reviewing and coordinating policy; (ii) introducing self-regulating mechanisms; (iii) updating and upgrading skills; (iv) establishing a

comprehensive institutional network; and (v) enhancing outreach to special microfinance groups.

189. **Reviewing and Coordinating Policy.** Phase II activities will continue.

190. **Introducing Self-Regulating Mechanisms.** It is neither feasible nor cost effective for NBC to monitor the performance of a multitude of NGOs as their number grow. Self-regulation accompanied by performance standards is better suited for monitoring small NGOs that would neither qualify immediately nor choose to become licensed MFIs. This function can be undertaken by a coalition of NGOs, by RDB, or by rating agencies as the sector grows in size and sophistication. Self-regulation could be based on historical performance standards, disclosures, and transparency. NBC should eventually confine itself to licensed institutions.

191. **Updating and Upgrading Skills.** The specialized training/resource ~~centerestablished during Phase II need~~centers established during Phase II will need to develop linkages with regional institutions and continually update their capacities and the quality of their courses. In addition, activities initiated during Phase II will continue.

192. **Establishing a Comprehensive Institutional Network.** To extend the institutional network, small farmer or community-owned institutions will be provided with a legal framework to enable them to integrate with the financial sector and upscale their operations. Depending on the size of the institutional network, NBC will review the equity threshold and other criteria for licensing MFIs.

193. **Enhancing Outreach to Special Microfinance Groups.** Successful pilots in Phase II will be replicated during Phase III to cover those disabled during conflict or by land mines. Correspondingly, the coverage of safety nets will be enlarged.

D. The Insurance Sector and Pension System

194. The development of the insurance sector will also go through three phases. To tackle the weak legal infrastructure and supervisory capacity, the first phase aims at establishing the foundation of the insurance business and building capacity for the sector. With a solid foundation in place, the insurance sector will develop in size and diversity. The focus of the second phase will be to promote the insurance market through private sector development, to increase outreach to the poor and to rural areas, to implement compulsory insurance, and to enhance product variety. The implementation of compulsory insurance will create policy-driven demand, and the growing income will generate demand for diverse insurance products. In response to the growing sophistication and volume of insurance business, an independent insurance supervisor will be needed. As the insurance sector further expands, the independent insurance supervisor will also upgrade prudential regulations in the third phase.

195. During the first phase of pension system development, the feasibility and design for establishing a multi-pillar pension system will be completed. In Phase II, the legal, regulatory, and supervisory frameworks will be established for the pension system. In addition, capacity-building mechanisms will be needed to ensure that staff of the regulatory and supervisory body are properly trained. During Phase III, the legal framework will be implemented through the issuance of sub-decrees. The mandatory public pension program will be launched, and the supervisory and regulatory framework will be further strengthened in anticipation of the implementation of the mandatory privately managed funded pension program that will be implemented after Phase III.

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

196. Five intermediate agendas are identified to establish the foundation for the insurance sector and determine the feasibility of a multi-pillar pension system:

(i) establishing a regulatory and supervisory framework for insurance,

(ii) establishing a framework for compulsory insurance,

(iii) establishing a basis for private sector development,

(iv) building the capacity of insurance regulators and supervisors, and

(v) conducting a feasibility study to establish a multi-pillar pension system.

197. **Establishing a Regulatory and Supervisory Framework for Insurance.** With the promulgation of the new insurance law, the Government needs to establish a framework for insurance regulation and supervision. The following policy actions need to be done:

(i) establishing an insurance supervisory unit within MEF;

(ii) adopting a subdecree to implement the insurance law; and

(iii) establishing a complete body of prudential regulations, including a uniform chart of accounts consistent with IAS and PCA system.

198. **Establishing a Framework for Compulsory Insurance.** The Government has introduced compulsory insurance in the new Insurance Law and has committed to develop compulsory insurance framework. To establish an efficient enforcement and monitoring mechanism, coordination and cooperation among concerned ministries are crucial. Thus, the Government needs to establish an interministerial working group to set up an enforcement and monitoring framework for compulsory insurance. In addition, an official plan should be adopted to coordinate the efforts of related ministries toward formulating a legal framework and enforcement mechanisms for compulsory insurance. The preparatory works may also include promulgation or revision of the related supporting laws.

199. **Establishing a Basis for Private Sector Development.** The market orientation of the insurance sector will be enhanced by the privatization of CAMINCO through a joint venture with a private company. Although it is expected that an increased minimum capital requirement will lead to the consolidation of the industry, it is also necessary to keep the insurance sector exposed to sound competitive forces. In fact, given the relatively high level of minimum capital requirement with regard to the market size, the oligopolisitic structure remain intact in the medium term. Thus, the Government must create a transparent entry mechanism to encourage private sector participation in the market. Furthermore, the Government should consider adopting regulations to encourage the use of domestic insurance companies.

200. **Building the Capacity of Insurance Regulators and Supervisors.** To ensure effective supervision and regulation, intensive capacity building must be conducted for supervisors and

regulators. Initial capacity-building efforts require assistance from aid agencies and foreign insurance training institutes. The Government must actively seek technical and financial assistance from aid agencies. To do this, the Insurance Office of MEF must develop a training plan which identifies training needs and resource requirements. The plan should include a training program for related Government agencies that will be involved in the enforcement and monitoring of compulsory insurance. The capacity-building mechanism for compulsory insurance must be addressed in the official plan for compulsory insurance development.

201. **Conducting a Feasibility Study to Establish a Multi-pillar Pension System**. A feasibility study must be conducted to determine the appropriate design and timing for a multi-pillar pension system, consisting of a mandatory public pension program, a mandatory privately managed funded pension program, and voluntary retirement savings programs. The feasibility study should include demographic projections, determination of the most appropriate institutions to administer and manage the different components of the pension system, appropriate legal framework, supervisory and regulatory arrangements, and funding mechanisms.

2. Phase II: Promote an Insurance Market through Private Sector Development and Establish a Foundation for the Pension System.

202. The key policy goal in the second phase is to enlarge and expand the insurance sector through private sector development, and to establish a foundation for the pension system. To achieve this goal, nine intermediate reform actions are needed:

(i) strengthening the insurance regulation and supervisory framework,

(ii) implementing compulsory insurance,

(iii) promoting a competitive private sector insurance market,

(iv) increasing outreach to rural areas,

(v) establishing a training institution for the insurance sector,

(vi) developing an actuarial professional body,

(vii) establishing a legal framework for pension system;

(viii) establishing a regulatory and supervisory framework for pension system, and

(ix) building the capacity of pension regulators and supervisors.

203. **Strengthening the Insurance Regulation and Supervisory Framework.** As the insurance sector expands, the insurance regulatory and supervisory framework will need to be strengthened by refining existing regulations and adopting new regulations to address the increased diversity of insurance products. In addition, the Government should allocate more resources to reinforce the regulatory and supervisory body and the enforcement mechanism. The insurance division needs to attract additional qualified staff.

204. **Implementing Compulsory Insurance.** With the establishment of the enforcement/ monitoring framework and other preparatory work accomplished during Phase I, the Government will be ready to implement compulsory insurance. It is essential at this stage that

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

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

206. **Increasing Outreach to Rural Areas.** Increased outreach of the insurance sector will have a direct poverty-reduction impact on the rural areas. Competition among private insurance companies will eventually drive them to expand their business into rural areas. Although improvement in the payment system and other banking services will also create a synergic impact on the capacity of the insurance sector, the Government may need to adopt an incentive system to further encourage the voluntary expansion of private companies' business into rural areas. Such an incentive system should encourage the insurance sector to develop products and distribution channels for providing insurance services in rural areas. New products could include crop insurance and other types of natural disaster insurance.

207. **Establishing a Training Institution for the Insurance Sector.** The Government needs to establish a comprehensive insurance training institution in the second phase. As the sector size increases and products diversify, so will the demand for a comprehensive training institution grow. Private and public sector partnerships will be essential in pooling resources to ~~creatie~~create an effective and financially sustainable institution that will play an essential role in capacity building in the sector by attracting international assistance and best practices to Cambodia.

208. **Developing an Actuarial Professional Body.** As the insurance sector grows, the Government should develop an actuarial professional body and adopt a relevant legal and regulatory framework, including a code of ethics and professional standards. The actuarial professional body will also be a center for capacity building for actuaries.

209. **Establishing a Legal Framework for Pension System.** The pension system design formulated during Phase I will determine the necessary laws that need to be adopted. The pension law(s) must cover the three pillars of the pension system: a mandatory public pension program, a mandatory privately managed funded pension program, and a voluntary retirement savings program. The Government also needs to identify the appropriate implementing, administration, regulatory, and supervisory body for each component.

210. **Establishing a Regulatory and Supervisory Framework for Pension System.** Given the development stage of Cambodia, a comprehensive regulatory and supervisory regime must be established based on the specific components of the pension system as well as the sequence of their implementation. The regulatory and supervisory regime for the mandatory public pension program should receive first priority. Rules concerning eligibility, calculation of benefits, and funding mechanisms must be considered.

211. **Building the Capacity of Pension Regulators and Supervisors.** To ensure effective supervision and regulation, intensive capacity building must be provided for supervisors and

regulators. Initial capacity-building efforts will need assistance from donor agencies and foreign training institutes.

3. Phase III: Strengthen the Insurance Sector and initiate the Establishment of a Pension System.

212. In this phase, further strengthening of the insurance sector and development of a pension system are accomplished through the following five intermediate reform agendas:

(i) upgrading prudential regulations for the insurance sector;

(ii) implementing a legal framework for pension system;

(iii) implementing a mandatory public pension program;

(iv) strengthening the regulatory and supervisory capacity for the pension system; and

(v) establishing a capacity-building institution for pension sector.

213. **Upgrading Prudential Regulations for the Insurance Sector.** With the expansion of the sector, the Government may decide to establish an independent insurance supervisory body. An independent supervisor will undertake two fundamental functions toward the development of the insurance sector: (i) attract qualified insurance specialists through a competitive compensation scheme, and (ii) enhance supervisory capacity and the prudential regulations in accordance with the Core Principles of the International Association of Insurance Supervisors. Enhanced supervisory capacity would bolster public confidence and thus facilitate the development of the insurance sector.

214. **Implementing a Legal Framework for the Pension System.** To become operational, the pension law needs implementing sub-decrees. Therefore, the Government must adopt sub-decrees that provide operational guidance to the appropriate ministries to implement the pension law. The sub-decree pertaining to the mandatory public pension program should receive first priority.

215. **Implementing a Mandatory Public Pension Program.** The mandatory public pension program should be implemented based on the adoption and establishment of the law and sub-decrees and the institutional development accomplished during Phases II and the early part of Phase III.

216. **Strengthening the Regulatory and Supervisory Capacity for the Pension System.** As the mandatory public pension program is launched, the relevant prudential regulations should be refined and enhanced in preparation for the implementation of the next pillar of the pension system – the mandatory privately managed funded pension program. In addition, the pension supervisory body must be strengthened by enlarging the staff with qualified personnel.

217. **Establishing a Capacity-Building Institution for the Pension System.** The Government needs to establish a comprehensive pension-training institution during Phase III. In anticipation of the introduction of the mandatory privately managed funded pension program, a training institution must be established as a cost-effective and efficient means of preparing staff for both private sector and public sector needs. The establishment of private and public

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

E. Nonbank Financial Institutions

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

1. Phase II: Lay the Foundation for NBFIs

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

(i) developing the leasing business,

(ii) developing money market intermediaries, and

(iii) developing capital market intermediaries.

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

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

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

with the establishment of the securities exchange, the Government should also establish a legal and regulatory framework for (i) securities companies/subsidiaries, investment advisory companies, and securities finance companies; and (ii) banks to establish securities subsidiaries. If commercial banks become securities brokers/dealers, the capital market supervisor must coordinate with NBC regarding the division of supervision responsibilities.

2. Phase III: Promote Diversification of NBFIs

223. In the third phase, the Government needs to make an effort to establish a balanced financial system. To achieve this goal, the following intermediate reforms are proposed:

(i) developing institutional investors for capital markets, and

(ii) establishing DFIs to promote medium and long-term lending.

224. **Developing Institutional Investors for Capital Markets.** For sound development of capital markets, diverse institutional investors need to be developed such as the trust business in banks, investment/management trust companies, mutual funds, venture capital companies, and the like. Thus, the Government needs to establish a proper legal and regulatory framework for these institutional investors.

225. **Establishing DFIs to Promote Medium and Long-term Lending**. The Government also needs to establish DFIs to supplement the capital markets by intermediating long-term capital at home and abroad and therefore facilitating growth-oriented investments. Thus, in the third phase, the Government should provide a legal and regulatory framework for medium- and long-term export-import credit institutions (such as the US Export-Import Bank) and other DFIs.

F. Interbank/Money Markets

226. The sequencing and pacing in money market development need to be aligned with development of the banking and nonbanking sectors. The development plan targets three strategic goals. The first phase aims to establish the foundation for short term unsecured interbank markets and to provide a base for interbank/money markets through the issuance of T-Bills and the promulgation of a negotiable instruments law. The second phase will strengthen interbank markets, establish regulations for diversified money market instruments such as negotiable certificates of deposit and repurchase agreements, and develop a primary dealer system and regularize the issuance of T-Bills. The third phase aims to broaden the interbank/ money markets with a regulatory framework for nonfinancial issuers of money market instruments such as commercial paper.

1. Phase I: Establish a Foundation for Interbank/Money Markets

227. To achieve the goal of the first phase, three intermediate reforms are desired:

(i) establishing interbank market arrangements for the banking sector,

(ii) creating an enabling environment for money market development, and

(iii) creating an enabling environment for T-Bills.

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

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

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

2. Phase II: Strengthen the Interbank/Money Markets

231. From the second phase, the money markets will develop to the fullest extent with strengthening of market microstructure, introduction of diverse instruments, and increased participation of financial institutions, including NBFIs. Phase II targets three intermediate reforms:

(i) expanding the scope of interbank markets,

(ii) establishing regulations governing financial institutions’ instruments, and

(iii) developing T-Bill markets.

232. **Expanding the Scope of Interbank Markets.** With the availability of T-Bills and other government securities from the second phase, the money markets will be able to accommodate small banks and NBFIs by providing an interbank repurchase arrangement based on T-Bills and other government securities. To facilitate the expansion of the scope of the interbank market, NBC and the Bankers Association need to work together to develop a standardized contract for repurchase agreements and supporting regulations, based on international best practices.

233. **Establishing Regulations Governing Financial Institutions’ Instruments.** NBC needs to establish detailed regulations to enable the development of key money market instruments such as negotiable certificates of deposit (CDs) and repurchase agreements (RPs). However, the role of the central bank must be minimized in the regulation of these instruments in the context of monetary policy and consumer protection. To expedite the development of

money markets and monetary policy instruments, NBC may also consider issuing central bank securities (for example, central bank certificates of deposit~~tion~~) in line with the development of government securities.

234. **Developing T-Bill Markets**. The development of T-Bill markets will play an instrumental role in developing money markets because the market interest rate of T-Bills will set the benchmark for other money market instruments, and the T-Bills themselves will be used as key money market instruments. To further develop the T-Bill market, building on the preparatory work in the first phase, the Government needs to undertake two key policy actions. First, it must introduce a primary dealer system for government securities. Second, it must regularize the issuance of T-Bills. This measure should be carefully coordinated with rationalization of the function of the National Treasury.

3. Phase III: Increase the Depth of the Interbank/Money Markets

235. The reform efforts in the second phase will continue in the third phase with the expansion of the scope of both participants and instruments, thereby deepening the money markets. The reform agenda in the third phase includes:

(i) establishing integrated interbank markets, and

(ii) establishing regulations governing nonfinancial institutions' instruments.

236. **Establishing Integrated Interbank Markets.** The emergence of diverse financial institutions and an increase in financial transactions call for an even wider scope of interbank markets than before. Thus, the Government should aim to develop integrated interbank/money markets in the third phase. Since the lack of mutual confidence among various types of financial institutions – in particular, between seasoned institutions (such as commercial banks) and new institutions – might hamper the expansion of the interbank markets outside of seasoned institutions, the Government needs to scrutinize the regulatory framework to enhance confidence in the interbank/money markets.

237. **Establishing Regulations Governing Nonfinancial Institutions' Instruments.** The Government will also need to establish a regulatory framework for money market instruments issued by nonfinancial institutions such as commercial papers and trade bills. The introduction of money market instruments needs to be synchronized with the development of private bond markets as well as the emergence of diverse money market intermediaries such as investment companies and finance companies.

G. Capital Markets

238. The capital market development plan consists of three sequenced development goals. During Phase I, the Government is expected to accomplish the necessary preparatory work to create an enabling environment for capital markets. In the second phase, it is envisaged to establish the foundation for capital markets by establishing a securities exchange and the necessary infrastructure related to securities trading, as well as by adopting detailed regulations and procedures. Building on the preparatory work up to the second phase, it is expected that the Government will make systematic efforts to develop capital markets in Phase III.

1. Phase I: Create an Enabling Environment for Capital Markets

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

(i) establishing a key legal/regulatory framework,

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

(iii) building capacity for future capital market participants.

240. **Establishing a Key Legal/Regulatory Framework.** In line with the establishment of the legal infrastructure envisaged in Phase I (see Section H. Financial Market Infrastructure), the Government needs to establish a legal/regulatory framework to underpin the capital markets. In the first phase of capital market development, the following actions need to be taken. First, the Government needs to strengthen the capital market development unit with full-time staff to undertake the preparatory work for capital market development. The enlarged staff of the unit will be the basis for the future capital market supervisor, as well as an institutional basis to retain the knowledge transferred from externally funded TA. Second, the Government should develop a master plan for creating a functional capital market framework. Policy actions in the master plan needs to be synchronized with the progress in key legal and accounting reform. Third, the Government must conduct a feasibility study to assess the existence of a critical mass of potential securities issuers. The feasibility study should be a realistic assessment of the number of public companies (defined in the forthcoming Law on Commercial Enterprises) that would be willingly subjected to higher standards of corporate governance in accordance with new IAS/ISA. Fourth, the Government needs to draft a securities and exchange law, reflecting recent progress in legal reform. Finally, in line with drafting the securities and exchange law, and based on the feasibility study, the Government should determine the basic structure of exchange regulations such as listing requirements, auction rules for trading, corporate disclosure, and exchange membership.

241. **Creating an Enabling Environment for Public Bond Markets.** Along with the issuance of T-Bills, the Government should exert effort to develop diverse public bonds markets. The development of public bonds markets will be of strategic importance in the context of Cambodian economic and financial development. First, the issuance of diverse riel-denominated public bonds will contribute to de-dollarization along with macroeconomic stability. Second, the issuance of public bonds will contribute to the development of monetary policy and money markets by providing necessary instruments to establish the refinance/rediscount facility of NBC. Third, the issuance of public bonds will expedite the development of financial institutions by providing diverse investment assets. The benefit would be most pronounced in the insurance sector. In the initial stage of the development of fixed-income securities markets, priority should be given to government and other public entity bonds. Government bonds should include both marketable types (such as Treasury notes and bonds) and nonmarketable types (for example, like US Savings Bonds). The Government should also encourage public entities such as large state-owned infrastructure enterprises to issue bonds.

242. **Building Capacity for Future Capital Market Participants**. Since the notion of capital markets is new in Cambodia, it is necessary to conduct capacity-building activities for a wider group of stakeholders of capital markets. The first and urgent group to train through international cooperation is the future regulators and players in capital markets. In addition, the Government needs to conduct comprehensive public awareness activities for capital markets.

2. Phase II: Establish the Foundation for Capital Markets

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

(i) establishing a capital market surveillance framework,

(ii) establishing a securities exchange,

(iii) promoting the issuance of public bonds, and

(iv) strengthening capacity building for the public.

244. **Establishing a Capital Market Surveillance Framework.** With the adoption of the securities and exchange law and its implementing regulations, the Government should establish a securities market supervision and surveillance body. The decision on the institutional modality of the capital market surveillance body must consider the availability of a critical mass of issuers, that will enable a financially independent capital market supervisor. In the initial stage of capital market development, the Government can consider two options for the supervisor: (i) a capital market surveillance unit under the related line ministry, or (ii) a full-fledged SEC. Without a sufficient number of listed companies, it would be academic to set up a full-fledged independent SEC because it could not finance its own budget. Without fiscal autonomy, the independence of a SEC can be notional. In this case, a capital market surveillance unit under the related line ministry is a realistic option in the initial stage of capital market development as the unit can benefit from full budget and administrative support.

245. **Establishing a Securities Exchange.** The Government must develop a detailed action plan to establish a securities exchange. The plan should include the design of the management structure of the securities exchange, membership and board of directors, trading system, and surveillance mechanism. Cambodia needs to establish a computerized exchange trading system, taking advantage of new technology as a latecomer. In addition, the ownership of the securities exchange is a critical issue to be decided in this phase. The Government must also develop a plan to establish a trading infrastructure such as a securities depository system and a clearing system. Since the capital market infrastructure requires substantial fiscal and technical resources, the capital market supervisor needs to secure international cooperation.

246. **Promoting the Issuance of Public Bonds**. To facilitate the issuance of diverse public bonds, the Government needs to establish or refine the related legal and regulatory frameworks. Creating a proper demand base for the public bonds market is also crucial in the early stages. Thus, the Government must consider an incentive system to create a demand for public bonds.

247. **Strengthening Capacity Building for the Public.** The Government should continue to conduct comprehensive public awareness activities. In this phase, the Government may need to publish a detailed master plan to create a securities exchange and provide general guidelines for listing requirements.

3. Phase III: Develop Capital Markets

248. With the opening of the securities exchange, one of the most critical issues in the third phase is to promote participation of both issuers and investors. To accomplish this goal, four intermediate actions are needed:

(i) strengthening capital market supervision and surveillance,

(ii) promoting capital market participation,

(iii) developing private bonds markets, and

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

249. **Strengthening Capital Market Supervision and Surveillance.** Capital market supervision and surveillance calls for extensive technical capability on the part of the supervisor. In the third phase, the Government may establish a long-term plan to build the capacity of supervisory staff. With the establishment of a securities exchange and the development of the capital market industry, the capital market supervisor will soon have to face competition from the private sector in attracting competent staff. Unless the capital market supervisor provides strong pecuniary and nonpecuniary incentives to potential staff, it will be difficult to attract competent new recruits. With the strengthening of the capital market supervisor, the Government will need to begin upgrading prudential regulations in accordance with IOSCO principles.

250. **Promoting Capital Market Participation.** A critical challenge in the initial stage of capital market development is to attract a sufficient number of listing companies. The Government needs to adopt carefully designed incentives to encourage firms to go public, while bearing in mind the potential adverse selection problem. The Government should also promote sound governance principles for listing companies to promote investor confidence. Thus, with the expansion of listing firms, the capital market supervisor should design a policy framework to promote sound corporate governance. This can be done by adopting corporate governance principles and enforce them through listing requirements.

251. **Developing Private Bonds Markets.** To accommodate the diverse financing needs of firms, the Government needs to adopt a comprehensive plan to develop corporate debt markets. The Government should provide a legal and regulatory framework for the large commercial banks and DFIs to issue bonds. In addition, The Government also needs to support the development of a trading system for fixed-income securities.

252. **Strengthening Capacity Building Activities for Capital Market Participants**. In the third phase, the Government should further strengthen capacity building activities for capital market participants. Thus, it may consider establishing a capital market training institution. In addition, it should promote the establishment of a securities brokers and dealers association as a capital market self-regulatory organization. The association can also assume the role of professional capacity-building institution.

H. Financial Market Infrastructure

1. Develop Legal Infrastructure

253. The development of legal infrastructure targets three reform agendas as follows:

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

(ii) Phase II: strengthening law enforcement, and

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

254. **Creating the Legal Infrastructure to Support Financial Sector Development**. In the first phase, the Government is expected to establish key laws underpinning financial sector and private sector development. These include civil code, company law, bankruptcy law, secured transactions law, commercial contract law, and commercial arbitration procedure. The Government should also initiate comprehensive judicial reform supported by ADB and World Bank. First, the Government needs to adopt and implement a master plan for judicial reform. Second, it should adopt the Law on the Organization and Function of the Court. The draft should include the establishment of a commercial chamber to undertake commercial cases.

255. **Strengthening Law Enforcement.** Building on the reform efforts in the first phase, the Government should make an effort to strengthen law enforcement in the second phase. This includes (i) continuing judiciary reform, (ii) establishing a commercial chamber in the court system, (iii) developing and adequate compensation scheme and capacity for commercial court jurists, and (iv) establishing a public registry for secured transactions.

256. **Enhancing the Legal Infrastructure for Private Sector Development.** The Government's effort to reform the judiciary system to support private sector development will be completed in the third phase, during which the Government needs to allocate more resources to improve and enlarge the legal infrastructure to underpin commercial activities. For example, following the establishment of a public registry for real estate in the second phase, the Government needs to adopt a legal/regulatory framework for a public registry for movables. Since the registration system for movables may require the participation and cooperation of multiple line ministries, the Government may need to establish an interministerial committee.

2. Develop an Accounting and Auditing System

257. Development of accounting and auditing system consists of a three-phase reform agenda over 10 years as follows:

(i) Phase I: establishing accounting and auditing standards and an enforcement system,

(ii) Phase II: strengthening enforcement of accounting and auditing standards, and

(iii) Phase III: enhancing the enforcement of accounting standards.

258. **Establishing Accounting and Auditing Standards and an E~~nforcement~~nforcement System.** In the first phase, the Government will complete the establishment of a basic accounting and auditing system. This includes (i) promulgation of the Law on Corporate Accounts, their Audit, and the Accounting Profession; (ii) application of IAS/ISA to all companies incorporated in Cambodia; (iii) establishment of a national accounting council; (iv) adoption of a code of ethics; and (v) establishment of an association of accountants and auditors.

259. **Strengthening Enforcement of Accounting and Auditing Standards.** In the second phase, the Government will strengthen the enforcement of accounting and auditing standards. This will be accomplished by promoting competition in the local accounting industry to encourage new entries in order to reduce the accounting and auditing and compliance costs of the private sector.

260. **Enhancing the Enforcement of Accounting and Auditing Standards.** In the second phase, the Government will further expand the scope of application of IAS/ISA into private companies. Efforts toward improvement in the enforcement of accounting and auditing standards will continue in the third phase.

3. Develop Financial Information Infrastructure

261. Developing a financial information system is crucial to cultivate the credit and repayment culture from the early stage of financial development. These efforts include three strategic reform agendas over the next 10 years as follows:

(i) Phase I: creating a financial market information system,

(ii) Phase II: expanding the scope of the arrangements for sharing information among members of the Bankers Association, and

(iii) Phase III: diversifying and upgrading the market information system.

262. **Creating a Financial Market Information System**. The Government needs to establish arrangements for sharing information among members of the Bankers Association to support the banks' credit operations. Establishment of such arrangements requires the collaboration of NBC and the Bankers Association. NBC must provide a regulatory framework governing integration of credit information from commercial banks. The Bankers Association must establish a detailed procedure to establish and maintain the credit reference database with the lowest compliance costs of member banks. The Bankers Association needs to mobilize the necessary resources to set up the hardware/software system for these arrangements.

263. **Expanding the Scope of the Arrangements for Sharing Credit Information**. In the second phase, the arrangements for sharing credit information should allow the participation of other financial institutions upon their emergence and the diversification of financial services. The expanding scope of participating institutions will require an amendment of the regulations and the establishment of a cost-sharing mechanism.

264. **Diversifying and Upgrading the Market Information System.** The Government needs to further develop financial information systems by introducing diverse information infrastructure. This includes the development of a financial sector database industry and a credit rating agency to support debt markets. In addition, the Bankers Association will need to upgrade the capacity and accessibility of the arrangements for sharing credit information through increased investment in IT.

4. Develop a Financial Sector Safety Net

265. Financial safety is required to enhance public confidence in the financial system. In the early stage of financial sector development, the systemic risk may be minimal because of underdevelopment. However, as the financial system expands, so does the systemic risk.

Therefore, the Government needs to address financial safety nets with the development of the financial system. This includes a two-stage reform agenda:

(i) Phase II: enhancing the banking sector safety nets; and

(ii) Phase III: expanding the financial sector safety nets.

266. **Enhancing the Banking Sector Safety Net**. The Government first needs to establish the banking sector safety nets, which includes (i) introduction of a deposit insurance system for the banking sector, and (ii) adoption of corporate governance guidelines for banks. Establishment of a deposit insurance system needs to be coordinated with the reform in reserve requirements for commercial banks. For example, NBC might amend the regulations regarding capital reserves, or guarantee deposits, and allow those funds to be invested as seed money for the deposit insurance system. This can be done in two ways. First, NBC can separate the capital reserve from the NBC account and, with the endorsement of commercial banks, invest those funds in the deposit insurance system. The second option is to maintain the capital reserve but to allow the banks to fund the deposit insurance scheme. At the early stage of development of a deposit insurance system, the central bank can take responsibility for this system.

267. **Expanding the Scope of the Deposit Insurance System into the Nonbanking Sector**. As the nonbanking sector develops, it will also provide deposit-type debts, which need to be included under the deposit insurance system. Thus, the Government may need to adopt a revised legal framework for an expanded deposit insurance system to accommodate other credit institutions. In addition, the Government may need to change the governance structure of the deposit insurance system. That is, the Government may need to establish a separate deposit insurance corporation, independent from the central bank, to avoid conflict of interest. With the expansion of the scope in the deposit insurance system, it will be necessary to adopt corporate governance guidelines for nonbanking institutions.

V. CONCLUSION

268. Financial sector development in Cambodia, under the current socioeconomic and legal environment, poses a daunting challenge to the Government as well as to the private sector, as it requires tremendous prerequisites and concerted efforts in related sectors. Financial sector development is also a time-consuming process that requires well-coordinated sequencing of development efforts that in turn calls for continuous strengthening of the capacity and governance of key institutions in both the public and private sectors. Moreover, this process is a resource-intensive undertaking in terms of technical and financial resources.

269. The Blueprint attempts to provide a coherent strategy to help sequence and coordinate the efforts of policy makers and all stakeholders based on the sector development vision. The Blueprint will serve as the planning tool for related Government ministries to determine their short- and medium-term policy actions, to identify requirements for capacity building and technical resources, and to coordinate in accomplishing the sector-specific and cross-sector goals. It will also be a coordination panel for aid agencies to plan their assistance to the financial sector and thus minimize duplication.

270. The Blueprint envisages the development of a sound, market-oriented financial system in 10 years. The system is characterized as competitive, integrated, and efficient, which will

facilitate domestic resource mobilization and growth-oriented investments. By 2010, Cambodia will have a banking sector, insurance sector, pension system, and nonbanking sector that together will provide a wide range of services at lower costs in both urban and rural areas. Cambodia will also develop interbank/money markets and the base for capital markets that offer various means of financial instruments to meet the demands of both savers and investors. To enable and achieve these goals, the basic legal infrastructure, a common accounting and auditing system based on international standards, a reliable financial information system, and capacity-building institutions in both the private and public sectors will be developed. Continuous improvement in financial infrastructure will nurture an enabling environment for further development of the financial sector.

271. Financial sector development, as seen in the vision, critically depends on full-scale governance reform in public administration, public finance, and the judiciary and legal systems. These reforms will strengthen the accountability of institutions in the public sector and will in turn enable Cambodia's access to a continuous flow of official development assistance. With successful governance reforms in progress, Cambodia is expected to achieve an average annual economic growth rate of 7 percent from 2005 to 2020, which implies that its GDP will triple from about $3 billion in 2000 to more than $10 billion in 2010, and per capita income will more than double during the period.

272. To materialize its vision for the financial sector, the Blueprint includes long-term development strategies and sector development plans for seven critical areas. The sector development plans address necessary standards, laws, and regulations as well as the preparation of necessary human resources and the institutional capacity for implementation. These plans have been developed taking into consideration of the interrelation of (i) human and institutional capacity building, (ii) the development of related infrastructure, (iii) the establishment of legal and regulatory frameworks, (iv) the emergence of relevant financial markets, and (v) the availability of technology. Each sector development plan consists of a development goal, intermediate reform agenda, and illustrative policy measures in each phase. The development goal describes the sector strategy to achieve visions in each sector over three phases: 2001-2004, 2005-2007, and 2008-2010. The intermediate reform agenda in a specific phase describes tactics to attain the set goals. And the illustrative and indicative policy measures are designed to accomplish the intermediate reform agenda.

273. Successful implementation of the Blueprint relies on strong leadership, firm commitment, and tremendous efforts of the Government, especially MEF, MOC, and NBC. It also calls for the support of the private sector and the timely assistance of international aid agencies, as the active participation of the private sector and international agencies is indispensable as a source of technical and financial resources for successful implementation of the Blueprint.

274. Continuous refinement and updating of the Blueprint based on the progress made and the changing socioeconomic environment will enable the Government to maintain momentum in its development efforts, as well as facilitating coordination of development efforts among international aid agencies.