This research was selected by the National Bank of Cambodia (NBC) to present at the 10th NBC Annual Macroeconomic Conference on Climate Risks and the Green Economy Transition in December 2023 (Final Draft)

Article

The Cost of Climate Change: Assessing the Impacts of Climate Change and Sustainable Finance Opportunities in Cambodia

United Nations Economic and Social Commission for Asia and the Pacific, 2023 [1,2]

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Abstract: The risks that climate change pose have the potential for significant long-term impacts on Cambodia's financial and macroeconomic stability. In recognition of these threats, sustainable finance is gaining traction in Cambodia, with the country taking initial steps towards aligning its financial system with the Sustainable Development Goals (SDGs). This article, conducted in partnership with the National Bank of Cambodia (NBC), delves into the landscape of sustainable finance in Cambodia, identifying barriers and opportunities for the adoption of green and sustainable finance in the banking sector. The article highlights the need for a national sustainable finance vision and roadmap, a Sustainable Finance Task Force, and a phased approach to climate risk reporting and disclosure. Additionally, technical support, capacity building, credit enhancement tools, and awareness-raising are essential to fostering sustainable finance in Cambodia. By addressing the identified barriers and embracing best practices for green and sustainable banking, Cambodia can effectively channel capital towards the SDGs, reducing longer-term financial and macroeconomic stability risks.

Keywords: Sustainable finance, green finance, climate risks, disclosure and reporting, risk management systems, environmental, social and governance (ESG), Sustainable Development Goals (SDGs), nationally determined contributions (NDCs).

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1. Introduction

Cambodia has undergone a significant transition over the past two decades, making substantial progress towards its Sustainable Development Goals (SDGs) and graduating to lower-middle-income status.[1] Despite Cambodia's gains, climate change poses the potential for broad macroeconomic impacts and financial sector risks. Currently, Cambodia is the 12th most risk-prone country globally.[2] It is estimated that severe flooding and droughts due to climate change could reduce Cambodia's GDP (Gross Domestic Product) by roughly 10 per cent by 2050.[3] A significant loss of agricultural yield is also predicted due to the increasing incidence of extreme heat during the rice-growing season, particularly for poorer communities reliant upon rain-fed agriculture, exacerbating threats to the livelihoods of many vulnerable communities.[4] Without meaningful action to address these issues, Cambodia's hard-won economic gains could be eroded and pose systemic risks to the financial system and the country's economic stability more broadly.

Central banks are increasingly recognizing that climate change and environmental degradation pose risks to the financial system and have potential broader knock-on effects to the economy, such risks include increased risk of borrower defaults, increased risks to insurers, shifts in pricing, potential impacts to government revenue and fiscal space, among other socioeconomic challenges.[5] Approximately half of the central banks in Asia and the Pacific already have sustainability-oriented mandates or are considering climate change issues as part of their policy conduct.[6] While the National Bank of Cambodia does not officially recognize sustainability within its mandate of 'maintaining price stability in order to facilitate economic development,'[7] incorporating sustainability criteria into assessments and regulatory frameworks is becoming more urgent as climate change accelerates.

Additionally, the sheer scale of funds needed to finance the SDGs and address climate change is unprecedented. In Asia and the Pacific, it has been estimated that an additional US$ 1.5 trillion per year

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[1] ADB (2018). Basic 2018 Statistics. Manila; and ADB (2018). Key Indicators for Asia and the Pacific 2018. Manila.

[2] General Secretariat of the National Council for Sustainable Development/Ministry of Environment, the Kingdom of Cambodia (2020). Cambodia's Updated Nationally Determined Contributions. https://unfccc.int/sites/default/files/NDC/2022-06/20201231_NDC_Update_Cambodia.pdf

[3] The World Bank Group and Asia Development Bank (2021). Climate Risk Profile: Cambodia https://www.adb.org/sites/default/files/publication/722236/climate-risk-country-profile-cambodia.pdf

[4] Ibid.

[5] NGFS (2020c). Overview of Environmental Risk Analysis by Financial Institutions. https://www.ngfs.net/sites/default/files/medias/documents/overview_of_environmental_risk_analysis_by_financial_institutions.pdf

[6] Xiang-li Lim and Vatcharin Sirimaneetham (2021). Securing Green Development: Can Asia-Pacific Central Banks and Financial Supervisory Authorities do More?

[7] National Bank of Cambodia. (n.d.) Overview of Functions and Operations. Retrieved November 2023 https://www.nbc.gov.kh/english/about_the_bank/overview_of_functions_and_operation.php#:~:text=As%20the%20monetary%20authority%2C%20the,and%20financial%20institutions%20in%20Cambodia

is now needed to achieve the SDGs by 2030.[8] A range of traditional and innovative financing instruments must be leveraged to mobilize finance to address the impacts of climate change. Cambodia’s latest nationally determined contributions (NDCs) affirmed the country’s substantial financing needs as well as the urgency of providing funds for climate mitigation and adaptation initiatives.[9] The banking sector is well-positioned to play a key role in directing the flow of finance toward these objectives.

This article is an updated brief of the Policy Paper titled *Green and Sustainable Financial Market Analysis: Financing Cambodia’s Future* which was developed in partnership with the National Bank of Cambodia (NBC). The article discusses the growing momentum to better align finance with the Sustainable Development Goals and provides a comprehensive understanding of the policy and financing options to support Cambodia's commitments toward this transition. Furthermore, it supports the future development of NBC's green and sustainable financing strategy by examining the state of Cambodia's financial markets, identifying the barriers that constrain green and sustainable finance from realizing its potential in Cambodia and assessing financing gaps.

The study provides several recommendations including:

1. Developing a national sustainable finance vision and roadmap, to set a long-term policy framework that enables Cambodia’s national sustainable finance targets to align with the country's 2030 SDGs and Nationally Determined Contributions (NDCs) under the Paris Agreement.

2. Establish a Sustainable Finance Task Force to enhance the coordination and cooperation of key stakeholders and ensure that the roles and responsibilities of stakeholders are clear, and ensure that emerging regulations on sustainable and green finance are harmonized and aligned.

3. A phased approach to reporting and disclosure of climate risks is recommended for banks, financial institutions and listed entities. The policy should adopt a progressive phased approach with resources and training need to support this.

4. The provision of additional technical support and capacity building is critical to identify a robust investment pipeline suitable for sustainable financing. Various approaches can be considered, such as green budget tagging or the establishment of a green project preparation facility.

5. Supporting further development of credit enhancement and risk management tools to ensure capital is directed towards key sectors which support climate adaptation and mitigation efforts.

6. Fostering capacity building including awareness-raising and capacity building of international best practices concerning all aspects of sustainable finance. There is a need to identify institutional and capacity gaps at the agency level, particularly in departments that are in the nascent phases of

[8] UNESCAP (2019). Economic and Social Survey of Asia and the Pacific 2019: Ambitions beyond growth.
[9] Kingdom of Cambodia (2020). Cambodia’s Updated Nationally Determined Contribution (NDC).

engagement with sustainable finance. Training and capacity-building programs should be tailored accordingly.

7. Support a review of existing incentives and refine or establish additional incentives where appropriate.

Supporting the growth of green and sustainable finance is an opportunity for Cambodia to positively contribute to improving the environment and meet its SDGs. Setting up the conditions required for green and sustainable finance products and services to emerge will effectively channel capital towards the SDGs. Led by the government and collaborating closely with the private sector, financial markets in Cambodia have a critical role to play in helping to ensure a sustainable, resilient, and prosperous future in Cambodia.

2. Methodology

The study adopted a pragmatic and empirical approach to research so as to balance competing perspectives and better understand possible barriers that could stymie green and sustainable finance solutions so as to better enrich the proposed policy recommendations. The methodology included four stages. The first stage was the desk research and review. This provided background analysis of the context of the issues through policy documents and related position papers, and a review of current literature. Mapping key stakeholders and issues regarding green and sustainable finance in Cambodia – and the rationales underpinning the existing market and approach – facilitated the evaluation. The main topics examined in the desk research included: the state of the sustainable finance markets; Cambodia's banking and financial markets, including legal and regulatory frameworks; and the existing financial infrastructure and ecosystem. Current and emerging sustainable finance taxonomies and standards were also examined.

The second stage included a series of semi-structured interviews. At this stage, case studies were also used to draw out lessons learnt from experiences in the region and internationally. The third stage included distilling the findings from the desk review, the interviews and the case studies, and drawing conclusions and making recommendations based on the research and consultations. The preliminary draft report was reviewed by NBC and later drafts were shared with key stakeholders and institutions involved in sustainable finance for refinement. The final phase consisted of further consultations to incorporate feedback and gain stakeholder buy-in before finalization with NBC.

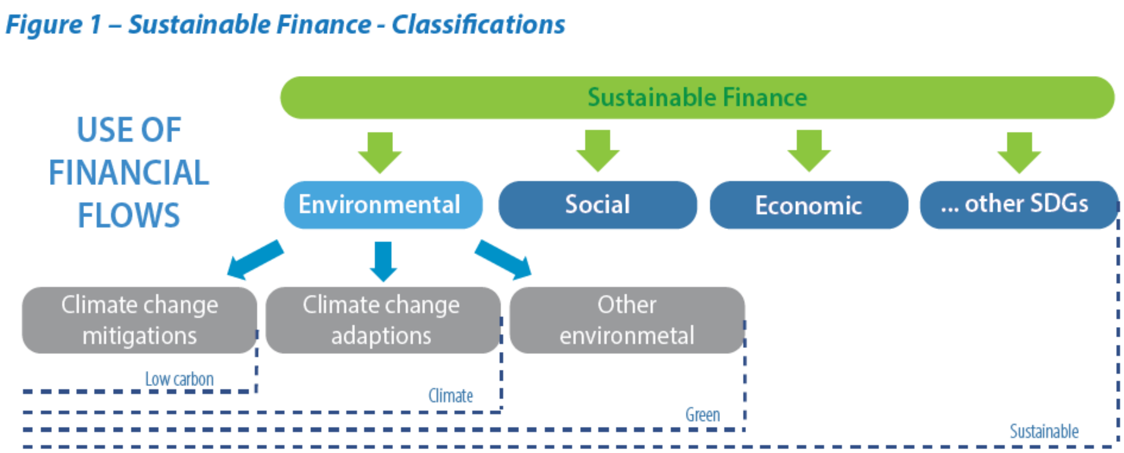
The interviews were conducted with a range of stakeholders both in-country and within the region including key government stakeholders such as the Ministry of Economy and Finance, the National Council for Sustainable Development and the Ministry of Environment. Interviews were also conducted with private sector actors, including banks and financial institutions and relevant service providers, and multilateral financial institutions, as they are crucial participants in sustainable finance markets.

3. Definitions - Green and Sustainable Finance

Green and sustainable finance are broad terms, and when used informally, the terms often overlap and the boundaries between the two are blurred. While the term 'green finance' and 'sustainable finance' are increasingly used globally, neither term has a universally agreed-upon definition, and both are continually evolving. Crucially, green and sustainable finance both seek to reconcile economic and financial performance with social and/or environmental impacts and to mobilize capital in a manner that promotes both economic growth and sustainable development. As such, green and sustainable finance are increasingly valuable tools to facilitate and promote sustainable development and fund projects with environmental, social, and economic benefits in line with the SDGs.

However, the two concepts have some important differences. Wherein green finance is a sub-set within the broader overarching sustainable finance categorization, sustainable finance is a comprehensive category concerning environmental, social, economic, and other SDGs aspects, supporting financial flows across a broad set of sectors required to support sustainable development (see Figure 1 – Sustainable Finance Classifications). Throughout this article, for clarity, the text will refer to sustainable finance unless expressly referencing green finance.

Figure 1 – Sustainable Finance Classifications



Source: Adapted from UN Environment Inquiry 2016b

3.1 Green Finance

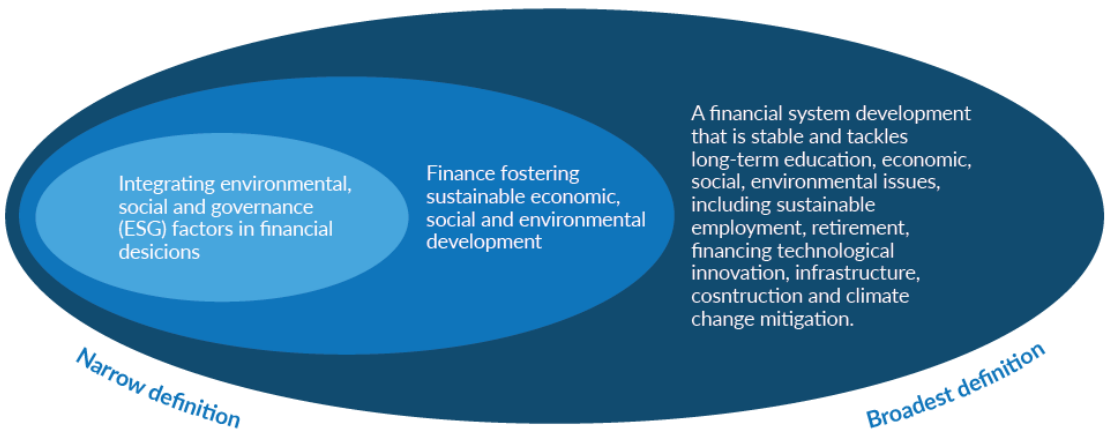
The G20 Green Finance Study Group describes green finance as **"the financing of investments that provide environmental benefits in the broader context of environmentally sustainable development".**[10] Green finance includes financial products and services that support initiatives that transform the economy towards a low-carbon environment and climate resilience. Products incorporate climate finance for mitigation and adaptation – such as renewable energy financing, energy efficiency, and sustainable agriculture and finance – and operate on the basis of a wider range of environmental objectives, including industrial resource efficiency and pollution control, water sanitation, and biodiversity protection.[11]

[10] Green Finance Study Group. (2016). G20 Green Finance Synthesis Report.
[11] Lindenberg, N. (2014). Definition of Green Finance.

3.2 Sustainable Finance

The concept of sustainable finance is a central component of this article. Yet a singular definition is undefined as sustainable finance can be considered at several levels, and as such, the definition is contingent on context as illustrated in Figure 2.

Figure 2 – Sustainable Finance - Definitions[12]



Source: EU High-Level Expert Group on Sustainable Finance (2017), Interim Report on Sustainable Finance, https://ec.europa.eu/info/sites/info/files/170713-sustainable-finance-report_en.pdf.

Currently, the Cambodian Sustainable Finance Principles and Implementation Guidelines define sustainable finance as **"the provision of financial products and services integrating environmental, social and governance (ESG) criteria into business or investment decisions aiming for long-term economic development that is not only economically viable but also environmentally responsible and socially relevant"**.[13] Whether the Government of Cambodia should adopt this as the final definition to frame regulation will be examined later in the context of further stakeholder engagement and standards (see Recommendations).

Sustainable finance, therefore, implies that financial institutions and markets incorporate environmental, social, and governance (ESG) risks within their lending and investment criteria, making it easier for environmentally conscious firms to access finance and harder for environmentally damaging companies to do so, and helping to embed good ESG practices into the business environment. Financial markets have

[12] EU High-Level Expert Group on Sustainable Finance (2018). Financing A sustainable European Economy.
[13] The Association of Banks in Cambodia (2019). Cambodian Sustainable Finance Principles Implementation Guidelines.

seen a substantial rise in ESG assets under management globally.[14] It is estimated that the global ESG market will reach a third of all assets under management by 2050.[15] Sustainable finance will be critical to closing the funding gap for the SDGs and climate targets. The next section will briefly examine the existing funding gap in Cambodia.

4. Financing Gap

The momentum for sustainable finance stems in part from a gap between what is required for sustainable development and what is currently flowing. While the overall financial discrepancy in Cambodia is clearly sizable, calculating the exact amount of the sustainable funding shortfall is difficult. However, drawing on government data, it is clear that the finance gap is considerable. For example, according to Cambodia's updated NDCs, the **total funding requirement for climate mitigation is approximately US$ 5.8 billion,** with the Forestry and Other Land Use (FOLU), waste, and energy sector actions requiring the most funding. In addition, the **total funding required for adaptation actions is over US$ 2 billion,** with infrastructure, water, and agriculture requiring the most funding.[16]

Table 1 - Summary of Mitigation Finance Needs

Sector	Estimated finance necessary (million US$)
Agriculture	49.4
Energy	672.1
Forestry	3,466.4
Industry	78.7
Waste	1490.3
Transport	10.6
General	3.1
TOTAL	5,770.6

Source: Cambodia's Updated Nationally Determined Contribution (NDC) 2020.

Table 2 - Summary of Adaptation Finance Needs

Sector	Estimated finance necessary (million US$)
Agriculture	306.3
Coastal Zones	72
Enabling actions	21.05
Energy	0.32
Human health	0.47
Industry	Not reported
Infrastructure	957.99
Livellihoods, poverty and biodiversity	211.13
Tourism	2.5 (as minimum)
Water resources	468.8
TOTAL	2,040.5

Source: Source: Cambodia's Updated Nationally Determined Contribution (NDC) 2020.

[14] Thematic bonds are akin to conventional fixed-income bonds, the main difference being that thematic bonds fund projects that generate environmental and social benefits. These include green, social bonds, sustainability bonds, and SDG-aligned bonds.
[15] Bloomberg Intelligence (2021). https://www.bloomberg.com/professional/blog/esg-assets-may-hit-53-trillion-by-2025-a-third-of-global-aum/.
[16] Kingdom of Cambodia (2020). Cambodia's Updated Nationally Determined Contribution (NDC).

The need for adaptation support cannot be overstated, given the National Council for Sustainable Development estimates that without investment in adaptation, climate change could cost Cambodia 1 per cent of GDP every year by 2030, and all economic growth could be wiped out entirely due to climate change impacts by 2050.[17]

For both mitigation and adaptation, most activities are conditional on international support, and of the actions specifically outlined in the NDCs, only five specify that implementation is possible, at least partially, through existing budget allocations.[18] Although Cambodia has received support from several climate funds, for example, over US$ 100 million from the Green Climate Fund (GCF),[19] the amounts are almost inconsequential relative to the size of the funding gap. This highlights the need to leverage all available tools, including financial markets, and to involve multiple stakeholders to address climate change. Public sources such as multilateral lending institutions and governments have historically financed many such projects in Asia. Still, commercial sources such as pension funds, wealth management funds, banks, and others are beginning to come to the fore. Despite the momentum gain, private capital deployment for sustainable finance in the region is still relatively limited. However, as Yulanda Chung, head of sustainability at DBS bank noted, *'Asia cares no less than their peers in Europe and America about sustainable development, and they're ready to put their money where their mouth is'* further noting that arguably the chief constraint to the growth of sustainable finance in the region *'has been the limited supply of bankable sustainable projects, but this too is changing'*.[20] This limited supply of bankable projects has also been reiterated by key sustainable finance stakeholders interviewed as part of this study; stakeholders noted that the lack of a clear investment pipeline hinders the flow of capital towards sustainable and green projects.

As mentioned, while a significant portion of investment would require public financing, the deployment of private capital through the banking sector is also crucial. Banks can play a pivotal role by offering green loans, investments, and other financial products that support sustainable practices and technologies. Incorporating climate risk assessments into bank lending products, through environmental and sustainability impact assessment can also direct capital towards NDC-aligned initiatives and lower portfolio risks in the long term. This approach aligns the financial sector with climate goals and opens up new markets and opportunities for green businesses, driving innovation and economic growth in environmentally friendly directions. Moreover, private capital can often mobilize resources more quickly and efficiently than public funds, making it an essential component in the global effort to combat climate change.

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[17] https://www.kh.undp.org/content/cambodia/en/home/presscenter/articles/2016/04/20/cambodia-needs-to-seize-the-opportunities-in-climate-finace.html#:~:text=At%20this%20critical%20juncture%20in,favorable%20environment%20in%20the%20country.

[18] Kingdom of Cambodia (2020). Cambodia's Updated Nationally Determined Contribution (NDC). The five activities are primarily capacity building and educational in nature.

[19] Green Climate Fund: https://www.greenclimate.fund/countries/cambodia#overview

[20] Doumbia, D., & Lauridsen, M. L. (2019). Closing the SDG Financing Gap in ASEAN: A Sustainable Finance Guide for Corporates.

5. Key Findings

5.1 Background Context

Cambodia is a bank-based economy with commercial banks as the primary source of funding, and approximately 90 per cent of Cambodia's financial assets are located in the country's banking system.[21] Credit is concentrated in several key sectors: wholesale and retail; agriculture; construction; and residential real estate.[22] In line with government policies, NBC measures to cushion the economic and social impacts of the pandemic helped maintain credit quality in the banking system and keep non-performing loans low, ensuring that the banking sector remained stable and resilient during the pandemic.[23] However, the Asian Development Bank (ADB) has warned that the pandemic, real estate lending, and faster credit growth combined with Cambodia's underdeveloped financial system has heightened financial stability risks.[24] Like many ASEAN economies, Cambodia also remains highly dependent on fossil fuels that contribute to climate change, which further exposes Cambodia's banks to financial risks.

Cambodia has taken preliminary steps to establish the enabling conditions for green and sustainable finance. Supported by the government – including the NBC, the Ministry of Environment, and the National Council for Sustainable Development – and international development partners, Cambodia has adopted a bottom-up approach to sustainable finance. Led by the Association of Banks in Cambodia (ABC), the Cambodian Sustainable Finance Initiative (CSFI) was established in 2016 and a memorandum of understanding (MOU) on 'Cooperation of Sustainable Finance' was signed between ABC and the Ministry of Environment and NBC in 2019, to strengthen and develop sustainable financial cooperation in the banking sector.

In 2019, the CSFI published the Cambodian Sustainable Finance Principles and Implementation Guidelines[25] (see Box 1 – CSFI Sustainable Finance Principles). The aim of the principles according to the CSFI is to 'consider environmental protection and the preservation of Cambodian culture in harmony with the sustainable livelihoods of Cambodians' and to help banks and financial institutions identify, mitigate, and manage E&S risks associated with their businesses and limit their own environmental footprint.[26] The development of the principles and guidelines is a positive step, and crucially, the principles embody ownership on the part of key local stakeholders and a distinctive Cambodian perspective on the issues. Furthermore, by committing to the principles, members have increased the potential impact of the framework. However, some stakeholders have expressed concern that the principles lack transparency and enforcement and may not be enough given their voluntary nature. Although the Cambodian

[21] https://www.abc.org.kh/banking-environment
[22] Ibid.
[23] https://www.thestar.com.my/aseanplus/aseanplus-news/2022/01/16/cambodia039s-banking-industry-sees-strong-growth-last-year-despite-pandemic
National Bank of Cambodia (2020).
[24] Asian Development Bank (2021). US$ 40 Million ADB Loan for Cambodia's Financial Sector Development.
[25] The Association of Banks in Cambodia (2019). Cambodian Sustainable Finance Principles Implementation Guidelines.
[26] Ibid.

Sustainable Finance Principles and Implementation Guidelines are a valuable start and touch on many of the UNEP-FI principles, further enhancement of the principles accompanied by sensitization and training on the application of these principles may be necessary.

The following subsections provide an overview of key findings in regard to the sustainable finance ecosystem and are based on key informant interviews with a range of both domestic and international sustainable finance stakeholders, as well as based on government consultations, documentation and desk review.

Furthermore, while not covered in the following sections, it should be noted that the Financial Sector Development Strategy 2016–2025 outlined several challenges that needed to be addressed to develop the securities market including providing (i) liquidity and depth in the market, (ii) flexibility and simplicity, (iii) the lowering of market access costs, (iv) the preparation of appropriate regulations and enforcement, (v) investor education, and (vi) system efficiencies and standards to support new developments.[27] In addition, the strategy noted that Cambodia would benefit from plans and standards developed by working groups within the ASEAN framework. Since the government adopted the strategy, significant progress has been made but many of the issues identified remain and need further work to support the establishment of sustainable financial markets in Cambodia.

5.2 Institutional Capacity and Awareness

Many key stakeholders have limited technical and institutional capacity to engage fully with sustainable finance. In addition, limited support services in the market, including legal, accounting, information services, and coordination, could bolster institutional capacity within the government and amongst financial institutions. Despite efforts by government actors –including the NBC, MEF and SERC, the ABC – and other stakeholders and development partners, the lack of institutional capacity and awareness to support the growth of sustainable finance remains a significant impediment. Responses from interviewees supporting early studies reaffirmed the finding that progress is still needed in training and capacity building for sustainable finance and customized programs to raise awareness.[28]

During interviews, stakeholders acknowledged that sustainable finance is new to Cambodia. The lack of awareness about sustainable finance and the absence of a common understanding of sustainable finance, combined with weak institutional capacity, limits the implementation of sustainable projects. Almost all local stakeholders interviewed indicated that their organizations were still in the incipient stages of engaging with sustainable finance and had limited knowledge of the topic. However, many institutions are in the process of developing action plans and reporting. Interviewees acknowledged that the majority of actors likely need greater incentives to encourage further action and that without clear financial signals from either the government or the market, the private sector is unlikely to act.

[27] Royal Government of Cambodia (2016). Financial Sector Development Strategy 2016–2025.

[28] Martin, P., Elbeltagy, Z., Hasannudin, Z. A., & Abe, M. (2021). Factors affecting the environmental and social risk management of financial institutions in selected Asia-Pacific developing countries. United Nations Economic and Social Commission for Asia and the Pacific.

5.3 Investment Pipeline

The lack of institutional capacity and awareness of sustainable finance is prevalent in both government and the private sector, including banks and financial institutions. It also intensifies the challenge of identifying suitable projects to build the investment pipeline and developing appropriate products and processes to manage the risks and opportunities presented by sustainable finance in Cambodia. Despite the demand for sustainable finance, as outlined earlier in Cambodia's financing gap analysis, a clear investment pipeline was not readily available at the time of this study.

Robust investment pipelines are not top-down exercises. They are identified and developed by banking and investment staff working with clients and project developers. In so doing, they recognize the trajectory of investable projects that require finance. However, the lack of awareness of sustainable finance and trained staff contributes to the scarcity of investment-ready projects that could meet established investment criteria. Hence, the required funds cannot flow to help meet the financing gap. Several stakeholders noted that Cambodia's green and social goals are closely intertwined — and suggested that combining green and social projects for example through ESG lending, would be beneficial to create a more robust pipeline of projects.

Beyond commercial banking, Cambodia has a robust microfinance ecosystem of which a significant number of lending products could qualify as green, or SDG aligned. Some microfinance (MFI) and microfinance deposit-taking (MDI) institutions have already begun assessing their lending portfolios in alignment with the SDGs. Such exercises can support these institutions to better understand and manage their environmental and social risks, and to identify and develop lending products that are more aligned with the SDGs. Additionally, this shift towards sustainable lending practices can enhance the reputation of these institutions, making them more appealing to a broader range of stakeholders.

5.4 Policies and Standards

Sustainable finance in Cambodia has been for the most part led by the ABC on a voluntary basis with support from NBC. Although there is broad support for sustainable finance among many stakeholders, and some Cambodian banks have international stakeholders that are increasingly embracing sustainable finance and ESG frameworks, Cambodian banks are often a small part of international parent bank's overall operation and hence not material for ESG risk management or reporting at the group level. However, this may change in time through the development of Environment and Social Risk Management (ESRM) of the existing portfolio. For example, Canadia Bank Plc Director of Finance, Ou Sophannarith has noted his bank supports the growth of the sustainable banking sector and securing environment protection.[29] Although mandatory regulations may not be required in the short term, policy clarity is essential to develop sustainable finance products and financial markets in Cambodia.

[29] Vireak, T. (2019). National Bank of Cambodia calls for green finance policies. Phnom Penh Post.

The sustainable finance ecosystem needs to be complemented by robust institutions and policies, as well as clear standards to ensure compliance. Without clarity on what is and what is not sustainable, financial sector stakeholders, especially investors, will struggle to allocate capital towards sustainable assets. The lack of clarity also creates a stumbling block to the measurement of environment-related hazards, making risk management more challenging.

The objective is to create a robust policy environment to facilitate sustainable finance and support innovation and collaboration among stakeholders. By setting a clear direction for the financial services sector, standard settings and regulatory guidance and supervision have an essential role to play. While there has been meaningful progress, more consistency and harmonization of policies and standards would enhance the market's ability to align with and support sustainable finance. Further, Cambodia's financial system and sustainable financial markets are part of an interconnected regional and global financial system and will need to establish relevant standards to access the wider international financial system.

6. Recommendations

The shortage of clear policy guidance, coupled with the lack of awareness and institutional capacity amongst key stakeholders, creates a substantial barrier to the development of the sustainable finance market in Cambodia. The aim of the recommendations is not only to support the mobilization of capital from a range of investors in pursuit of the SDGs by reducing the barriers to sustainable finance but also to foster the development of policies, processes, and systems needed to ensure ESG factors are fully integrated into mainstream financial decision-making.

Several core recommendations have been identified to help overcome the barriers to scaling up sustainable finance and the recommendations are subsequently broken into different elements. Key stakeholders and partners needed to drive the process forward have been identified, and actions mapped out in terms of priorities and sequencing. The focus has been on establishing a shared understanding and clarifying roles and responsibilities to entrench a long-term approach and build a robust sustainable financial market.

Recommendation 1 – NBC Sustainable Finance Vision and Roadmap

The first recommendation is for the National Bank of Cambodia to develop its sustainable finance vision and roadmap in order to promote sustainable finance across the banking sector in Cambodia. There are several examples of financial regulators within ASEAN who have already undertaken similar initiatives i.e. Bangko Sentral ng Pilipinas and Indonesia Financial Services Authority (OJK). It is suggested that the Roadmap, in the first stage, focus on the transition to a low-carbon economy within the banking sector. As noted in Recommendation 2, a working group or taskforce should be developed and tasked with developing detailed strategic plans supporting and operationalizing this Roadmap.

This policy roadmap needs to be complemented by the development of intermediate targets to be revisited on a biennial basis to ensure it remains on track, up-to-date with market best practices as sustainable finance is a rapidly evolving sector, and coherence among key stakeholders.

The objective of the roadmap is to support the creation of clear guidance and standard setting for sustainable finance practices. Through coordination with multiple stakeholders, the roadmap can facilitate the integration of sustainable finance principles into the broader policy objectives of the country beyond the banking sector. Furthermore it assists in risk management both of the financial regulator and of the financial institutions. The roadmap can also support financial sector innovation through the development of new products and services which better meet clients needs and align with sustainable objectives.

The development of the roadmap should start with standardizing the definition of sustainable finance, as discussed earlier. It must include clear SMART (Specific, Measurable, Attainable, Relevant, and Time-Bound) key performance indicators (KPIs). Once agreed, the roadmap must be fully budgeted and funded to ensure that it will be implemented. It is essential that the roadmap is aligned with other regional frameworks, such as that of ASEAN, to promote sustainable finance among and between the member states, as well as national strategies and frameworks such as the INFF. This will help ensure the comprehensive development of sustainable finance in the region and unified efforts across banking and insurance, capital market, and ancillary services.

Recommendation 2 - Establish a Sustainable Finance Task Force

The second recommendation is to develop a sustainable finance task force or working group to enhance coordination and cooperation of key stakeholders and ensure that the roles and responsibilities of stakeholders are clear. The task force should include key actors from the government and the private sector, including senior representatives from NBC, the Ministry of Economy and Finance, SERC, the National Council for Sustainable Development, the Ministry of Environment, ABC, the Insurance Association of Cambodia and other relevant institutions. The task force would be responsible for supporting the roadmap development and its implementation. Once the roadmap is agreed upon, it should be implemented in a coordinated manner by members to enhance cooperation between the public and private sector, build links between financial markets and key actors in the real economy, and create an enabling environment that looks at sustainable finance as the new business-as-usual.

Recommendation 3 – Adopt a Phased Approach to Disclosure Reporting

It is recommended that the NBC consider mandating banks to report and disclose climate risks. Resources and training will need to be allocated to support this, and the policy should adopt a progressive approach initially requiring <u>only</u> banks to report, while MFIs and MDIs reporting remain voluntary, with the latter possibly phased into required reporting in the future, as needed. To ensure the alignment of all actors, an incentive framework including training and capacity building should be developed as a first step to encourage change and support early adopters, with clear policy guidance, and only later should consideration be given to any mandatory regulation. Similarly, CSX can also consider a similar approach for listed entities on the exchange.

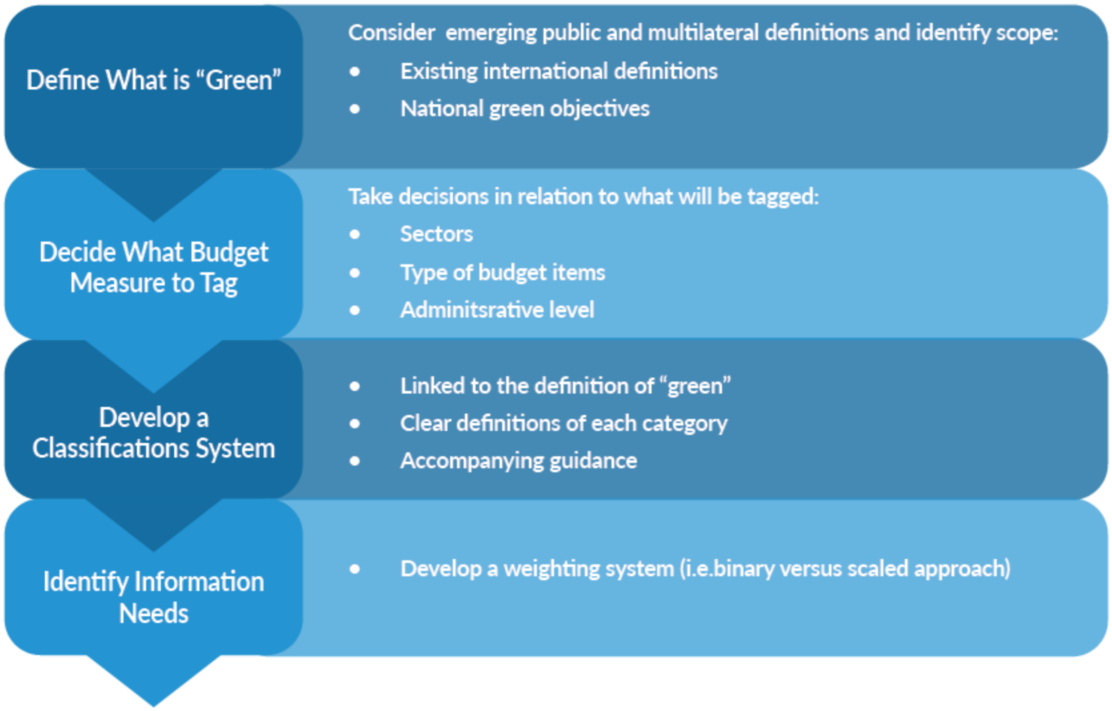
Notably, open dialogue and information sharing should be initiated with all key stakeholders, including representatives from banks and financial institutions, and with the CSX as a key stakeholder whose buy-in will be crucial.

Furthermore, data collection is a crucial element of disclosure reporting. Without access to relevant data, the information in the reports will be of limited value. The role of regulators is to agree on what needs to be reported. Banks, financial institutions, and other stakeholders will need to establish data collection systems to ensure they can subsequently report what is required. Banks and financial institutions will need time to develop these systems and to work with clients to ensure they have access to the underlying data required. Establishing these systems will also assist banks and financial institutions to develop in-house ESG risk management systems critical for mainstreaming sustainable finance. The NBC will also need to build its own systems to monitor and supervise the implementation of the proposed reporting approach. Such a system will support data and information gathering on financial sector stability and climate-related risks.

Recommendation 4 – Cultivate and Finance the Investment Pipeline

The provision of additional technical support and capacity building is critical to identify a robust investment pipeline suitable for sustainable financing. This is beyond the scope of NBC's mandate, however other taskforce members such as the ABC, Ministry of Environment, Ministry of Economy and Finance or Climate Change Secretariate may be suitable. To do so, it is recommended that several options be considered: firstly, introduce budget tagging as outlined in Figure 3 - The Steps for Green Tagging; secondly, establish a Green Project Preparation Facility to identify and develop green infrastructure. The facility can also be used to build capacity amongst the government and the private sector. Such a facility can provide support with pre-feasibility studies, impact assessments, and technical assistance and advisory services to identify bankable and investment-ready projects. Thirdly, the facility would examine possible initiatives and instruments to aggregate assets and structure risks. An example is the use of securitization to aggregate small-scale projects to make them suitable for sustainable financing via thematic bonds. Fourthly, it is necessary to develop innovative approaches by advocating and encouraging business innovations that can support reporting, analysis, and skills building on sustainable finance issues to assist businesses in cultivating sustainable investment projects.

Figure 3 - Steps for Green Tagging[30]



Source: Taken from: Green Budget Tagging: Introductory Guidance & Principles (Working Draft), OECD, GOV/PGC/SBO (2020)11, 5th October 2020 https://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=GOV/PGC/SBO(2020)11&docLanguage=En

Recommendation 5 – Credit Enhancement and Risk Management Tools

To effectively transition towards sustainable finance and move beyond conventional business practices, further development of credit enhancement instruments and risk management tools, such as foreign exchange hedging, is essential to enhance the viability of sustainable financial products. In this regard, the Cambodia Credit Guarantee Corporation (CCGC) stands as a prominent entity well-positioned to provide credit guarantees for green and sustainable loans.

Furthermore, blended finance, encompassing credit guarantees and subordinated debt, can play a crucial role in unlocking and scaling up sustainable finance in Cambodia by mitigating risks for senior lenders and reducing the burden of senior claims on assets. This approach is critical to accelerating development efforts and fostering a sustainable financial landscape in Cambodia.

Recommendation 6 - Capacity Building

A multi-phased approach to capacity building is recommended, including awareness-raising and capacity building of international best practices concerning all aspects of sustainable finance. In addition, there is a need to identify institutional and capacity gaps at the agency level, particularly in departments that are only starting to engage with sustainable finance, and tailor training and capacity-building programs accordingly. Knowledge-sharing sessions for different stakeholders to exchange experiences will also be fundamental at the incipient stage. ESCAP and development partners can provide capacity building to support local stakeholders to acquire the skills needed for these new activities. For example, ESCAP, GRI, UNEP-FI and WWF have developed the Finance Flows' Sustainable Banking Academy, which offers training to Southeast Asian Bankers on the adoption and implementation of the Principles for Responsible Banking. Capacity building amongst stakeholders should be co-designed, to ensure the diverse needs of different stakeholders and industry sectors are covered. Cambodia can also build capacity through regional cooperation in various forums, such as ASEAN.

7. Conclusions

Cambodia stands at a crucial juncture in its pursuit of sustainable development amidst the significant challenges posed by climate change. The country has achieved notable economic progress, yet the pervasive threats from climate change, demand an urgent and strategic approach to finance. The substantial funding gap identified, particularly in Cambodia's updated NDCs, calls for a synergistic approach that harnesses both public and private financial resources. The role of the banking sector is particularly significant, with its potential to channel finance towards sustainable initiatives via green loans and other innovative financial products.

The recommendations in this article offer a comprehensive strategy for advancing sustainable finance in Cambodia, addressing key barriers and fostering a robust market aligned with the SDGs. Notably, NBC has taken a significant step forward by adopting Recommendation 1, which focuses on developing a sustainable finance vision and roadmap. This initiative, undertaken in collaboration with ESCAP, is a pivotal move towards promoting sustainable finance across Cambodia's banking sector. Furthermore, NBC's commitment to this recommendation is complemented by plans to consider project pipeline development within the roadmap, which is crucial for identifying and nurturing investment opportunities that are both financially viable and aligned with sustainable objectives.

Through its analysis and recommendations, this article sets a clear path for Cambodia to not only mitigate the risks posed by climate change but also seize the opportunities presented by sustainable finance. By aligning financial practices with sustainable development goals, Cambodia can safeguard its economic progress, ensure environmental sustainability, and foster a resilient and prosperous future for its citizens.