



National Bank of Cambodia

# Banking Supervision



**Annual Report  
2005**

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## **Forward**

Following the reform of the Cambodian economy from a centralized to a free- market economy the banking system has grown stronger and stronger in line with the Law on Banks and Financial Institutions and the Financial Sector Blueprint 2001-2010. Indeed, in the year 2000, the National Bank of Cambodia, acting as the supervisory authority, implemented the Law on Banks and Financial Institutions and launched the relicensing campaign where 17 commercial banks were liquidated. As a result we can see improvements in the operation of the banks who received the new licenses and an increasing confidence from the public in the banking system. In addition to this, the new chart of account and other new regulations were issued to be implemented and on-site and off site supervision capacity are being continually upgraded. However there are still some misunderstandings from the public as to the role of the National Bank of Cambodia as the supervisory authority remain.

Bearing the matter in mind, I am pleased to present to you the Banking Supervision Annual Report 2005 for the use and need of the public. This report is a result of a long and hard work from our young supervisors. This is the first time for the Banking Supervision Department to compile such a report whose purpose is primarily to explain depositors, bankers, students and other interested parties on the role and responsibility of the bank supervisors. As will be explained in detail in this report, our supervisors are responsible to ensure a safe and sound banking system, promote the development of the banking system in the country and above all to protect depositors' interest. Also in this report you would find consolidated data of the banking system in Cambodia as compiled by the National Bank of Cambodia, which I hope, will be useful for depositors, academics, research institutes, bankers and investors.

To this date the National Bank of Cambodia has made considerable efforts in order to promote the banking system in the country. From the year 2000, deposits grew by 164% to 3,927 billion Riel in 2005, while loan to customers grew by 135% to 2,347 billions Riel. Microfinance institutions on the other hand, grew rapidly from 5 institutions in 2003 to 16 institutions in 2005 serving 345,189 customers with an outstanding of 187,177 million Riel, an increase of 44.2%. In 2005 the loan to customer and customer deposits consisted of 10.32% and 17.27% of GDP respectively.

This proved that the public grant more and more confidence in the banking system, as the banking system in itself plays more and more important role in the life of the public. Though this is an achievement the National Bank of Cambodia praised itself of, this is not enough. Strengthening the banking system's credibility is an ongoing job that the National Bank of Cambodia is committed to. As our supervisors are in the front line of this task, they are constantly trained and supported by international technical assistance in order to cope with the fast growing banking system.

With all things said, I sincerely hope that this report would assist all interested parties particularly depositors, students and researchers, to understand better our banking system and the role of the central bank.

**Governor**

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## INTRODUCTION

According to IMF data on the world economic overview, global and regional economic growth continues to be strong and inflation remains low. Generally speaking, the overall financial situation is favorable. The economic growth of the European Union is expected to decrease from 2% in 2004 to 1.2% in 2005, while the United States of America's economy could grow by as much 3.5% (4.2% in 2004). Global economic growth is expected to be 4.3% in 2005, compared to 5.1% in 2004.

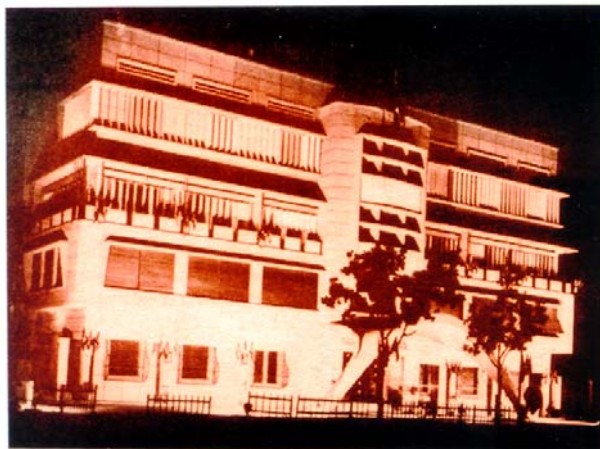
In 2005, Cambodia's economy grew by 13.1%, compared to 10% in 2004. The major factors were the increases in the agriculture sector (17%), service sector (11.9%), and garment sector (10.9%). The inflation rate of consumer prices increased to 6.7%, compared to 5.6% in 2004, due to the increase in oil prices and the drought in the beginning of the year. The exchange rate of riel compared to the dollar weakened by about 2%: KHR 4,035 per dollar (bid rate in the market) at the end of 2004 to KHR 4,117 per dollar by the end of 2005; i.e., KHR against US Dollar was stable in the first trimester, sharply decreased in the second trimester and the beginning of the third trimester, but increased in the final trimester of the year.

Financial operations development in the country was satisfying in 2005. Through institutional and legal reform under the financial sector blueprint 2001-2010, the financial sector has been improved and now successfully reflects the stability of the financial sector as well as the improvement of financial services. The National Bank of Cambodia is still in the early stages of establishing sound regulation and efficient supervision for the banking sector. Subsequent to consecutive issuance of *Prakas* and regulations since 2000 to implement the law on Banks and Financial Institutions, the National Bank of Cambodia promulgated in 2005 additional banking regulations and *Prakas* for those institutions to put into practice. The National Bank of Cambodia also compiled a draft law and *Prakas* on anti-money laundering and combating financing of terrorism, a draft law on leasing, and a draft *Prakas* on the credit information sharing system. At the end of 2005, loan to private sector were KHR 2.46 trillion, which were increased by 26.58% whereas bank deposits were KHR 3.93 trillion, which were enlarged by 18.01% compared to 2004.

## 1. CAMBODIAN BANKING AND FINANCIAL SYSTEM

### 1.1 History of the banking system in Cambodia

The National Bank of Cambodia was established on December 23, 1954, after the country gained independence from the French Government and after the Indochina Printing Institution was closed. The National Bank of Cambodia printed the Riel as its own national currency in order to completely terminate the monetary alliance with the Vietnamese and Laos currencies. During the period from April 17, 1975, to January 7, 1979, under the Pol Pot regime, the National Bank of Cambodia was closed, the banking system was totally destroyed, the National Bank of Cambodia building was ruined, and Riel banknotes were no longer used.



National Bank of Cambodia, 1960s

On October 10, 1979, the People's Bank of Cambodia, called "Bank of Cambodia", was re-established as the central bank of the country by sub-decree No 1211, and Riel banknotes were re-issued on March 20, 1980, to facilitate the exchange of goods and the payment of civil servants.



National Bank of Cambodia, 1979

In 1989, the banking system was reformed through the transformation of the twenty provincial and municipal banks into specialized provincial and municipal banks with economic and financial autonomy, while the People's Bank of Kampuchea played the role of monetary authority and directly supervised these banks.

In 1991, the political regime shifted from a planned economy to a free market economy, resulting in the switch of

Cambodia's banking system from a mono-banking system to the two-tier banking system presently in place. As a result, the state authorized banking activities in Cambodia to operate through the establishment of state joint venture banks. In 1993 three banks of the kind were established to be later entirely privatized. Foreign Trade Bank, however, remained a part of the National Bank of Cambodia until 2000 when it fully became a state-owned bank. These moves required the National Bank of Cambodia to further strengthen its role by improving its management capacity to direct and supervise other laws such as: (1) Law on the Organization and Conduction of the National Bank of Cambodia, adopted by National Assembly on January 26, 1996; (2) The Law on Foreign Exchange, adopted by National Assembly on August 22, 1997; and (3) The Law on Banking and Financial Institutions, adopted by National Assembly on November 18, 1999. Recently, the Law on Negotiable Instruments and Payment Transactions was adopted by the National Assembly on September 19, 2005.



During the early stages of the free market economy, commercial banks were established in the form of state joint venture banks in order to attract investors and to provide banking services to customers. In order to function as a central bank, the National Bank of Cambodia withdrew its shareholding interests in the equity of three state joint venture commercial banks fully in 1997 and completed the privatization of the Foreign Trade Bank in 2005. Up to the year 2000, 31 banking institutions obtained banking operation licenses.



National Bank of Cambodia, 1990s



National Bank of Cambodia, 2003

As part of the implementation of the Law on Banking and Financial Institutions, the banking system was restructured. At the end of 2005, the banking system of Cambodia consisted of the National Bank of Cambodia, 15 commercial banks (3 foreign bank branches), 4 specialized banks (1 state-owned) and 16 licensed microfinance institutions and 23 registered microfinance institutions (See appendix 01).

## 1.2 Bank restructuring in Cambodia

In the year 2000, by implementing the Law on Banking and Financial Institutions, many essential regulations were issued with the intention to restructure the banking system through the re-licensing mechanism. The National Bank of Cambodia issued action plans with deadlines for the submission and evaluation of the licensing applications.

### 1.2.1 Conditions for establishing a bank

Important criteria for banks to fulfill before obtaining the new license include:

- 1- The qualification of the shareholders and the adequacy of their audited financial condition.
- 2- The ability of the principal shareholders to fulfill, jointly and severally, their obligations to strengthen the bank's own funds if required to do so.
- 3- The adequacy of human, technical and financial resources for the planned activities.
- 4- The identification of shareholders holding 5% or more.
- 5- The minimum paid-up capital must equal to fifty billion riels (approximately thirteen million USD) for commercial banks and ten billion riels for specialized banks. It is important to note that the minimum paid capital before banks restructuring was 10 billion riels (five

million USD at the exchange rate of that time). At that time several commercial banks had unstable financial positions, while others had insufficient solvency ratios.

Those commercial banks which were in operation before the end of 1997 were required to top up their minimum capital requirement on 31 December 2001 at the latest. However, as this capital top up was the main problem faced by banks, the National Bank of Cambodia waived the dateline until the end of 2002 for those banks which showed improvement in their financial position.

### **1.2.2 Re-licensing procedure**

The first step in the re-licensing process was to diagnose banks based on the capital adequacy rules and other prudential ratios and measure the extent of the problems faced by individual banks. The measurements were based on the following three elements:

1. The rating based on CAMELS methodology and the information submitted in the bank's business plans;
2. Whether the new capital requirement of 50 billion riels (\$13 million) has been met; and
3. Whether corrective measures (prudential) are needed.

As a result, banks were classified into three categories:

- 4 viable and fully capitalized banks,
- 15 potentially viable banks. These are banks that need to increase capital and take other corrective measures,
- 16 non-viable banks, of which 11 voluntarily liquidated. Of these voluntarily liquidating banks, five were insolvent.

The viable and fully capitalized banks were re-licensed for three years, and the potentially viable banks were required to sign Memorandum of Understandings (MOUs) with the National Bank of Cambodia to commit additional capital and correct any errors found during critical diagnosis. The MOUs contained schedules for those banks to complete.

The National Bank of Cambodia required banks to arrange for a voluntary liquidation when they were not viable. The National Bank of Cambodia then arranged a purchase transaction in which a sound second bank would pay a small amount to assume some combination of assets and deposits from the non-viable banks. This would avoid losses for depositors and create a more favorable climate for liquidation.

The re-licensing process resulted in a significant reduction in the number of banks in the system and ensures that those that remain are strong enough to make a meaningful contribution to the development of the economy. After the restructuring process, the licensed banks were required to implement the uniform Chart of Accounts (COA).

### **1.2.3 Method of reimbursement of depositors' money**

The Law on Banking and Financial Institutions clearly defined the priority of the reimbursement of depositors' money when bank liquidations occurred. Reimbursement to depositors stands in the fourth rank after tax expenses, employees' salaries and other preferential shares.

1. A fixed method where each depositor shall receive an equal amount up to two million riels (US\$500 equivalent), and
2. Remaining assets shall be disbursed proportionally according to international practice.

All claims were settled in accordance to the priority stipulated in the Law on Banking and Financial Institutions, Article 64. Of the five insolvent banks only one had sufficient funds to reimburse its depositors.

#### **1.2.4 Privatization of Foreign Trade Bank of Cambodia**

In order to have a safe, sound and transparent banking system with fair competition, the National Bank of Cambodia and the Cambodian government privatized the Foreign Trade Bank of Cambodia. The privatization was completed on 28 October 2005, with Canadia Bank holding 46%, ING Holdings Co., Ltd, holding 44%, and the Ministry of Economics and Finance holding 10%.

### **1.3 Licensed and registered Microfinance Institutions**

Microfinance represents one sector of the Cambodian economy and has been established since the 1990s by national and international non-governmental organizations (NGOs). At the outset, the main activities of these organizations involved social health rehabilitation. Rehabilitation using humanitarian assistance cannot be disconnected from the financial need for capital of businesses. In this sense, some NGOs played the role of microfinance operators, in addition to their humanitarian activities, using funds from various international organizations.

Microfinance operations performed by NGOs in the 1990s were neither regulated nor supervised. The Law on Banking and Financial Institutions was promulgated in late 1999. The National Bank of Cambodia (NBC), the supervisory authority of the banking system, began reforming the banking system in Cambodia in early 2000. Reform programs included the reform of the microfinance sector to allow microfinance operators to transform themselves into companies of a commercial nature and be regulated under the laws and regulations of NBC. The regulation and supervision of microfinance institutions (MFIs) has the primary objectives of ensuring the sustainability of their operations and services, reducing the risk of lost deposits, and preventing failure due to bad management.

The licensed and registered MFIs are currently strengthening their management and expanding their activities into the remote areas where poor people hope to access financial services. This reflects a significant increase in lending, the number of borrowers, and voluntary saving.

At the end of 2005, according to the Off-site supervision department's finding, microfinance institutions have total loans outstanding of KHR 214,085 million (8.7% of the bank loans) provided to 377,505 customers and have total deposits of KHR 9,831 million (0.25% of total deposits in banks) mobilized from 141,051 customers. When compared with the year 2004, total loans outstanding increased by 30.15%, the number of borrowers increased by 17.21%, total deposits increased by 21.76%, and depositors increased by 14.69%.

### 1.3.1 License and registration conditions for microfinance institutions

*Prakas* on licensing and registration of microfinance institutions are stated as follows:

Licensing is compulsory for all microfinance institutions if they meet *one* of the following conditions:

- Minimum registered capital of KHR 250 million;
- Their loan portfolio outstanding is equal to or greater than KHR 1,000 million;
- They have 1,000 borrowers or more;
- The savings mobilized from the general public amounts to KHR 100 million or more;
- The number of depositors is 1,000 or more.

Registration with NBC is compulsory for all non-government organizations (NGOs), associations and other entities engaged in microfinance if they meet *one* of the following conditions:

- Their loan portfolio outstanding is equal to or greater than KHR 100 millions;
- The savings mobilized from the general public amount to KHR 1 million or more;
- The number of their depositors is 100 or more.

### 1.3.2 Other prudential regulations

The National Bank of Cambodia has adopted important new *Prakas* to strengthen the microfinance sector as follows:

- 1- *Prakas* on the calculation of the interest rate on microfinance loans;
- 2- *Prakas* on the classification and provisioning of loans for bad and doubtful debt for microfinance institutions;
- 3- *Prakas* on the reporting requirements from registered NGOs and licensed microfinance institutions;
- 4- *Prakas* on liquidity for microfinance institutions;
- 5- *Prakas* on the requirement reserve for microfinance institutions;
- 6- *Prakas* on adoption and implementation of chart of accounts for microfinance institutions.

## 1.4 Banking and Financial performance

### 1.4.1 Commercial and Specialized Banks

The year 2005 was a very dynamic year for the Banking Supervision department with the entry into the banking sector of one commercial bank, one specialized bank and six microfinance institutions. Besides prudential supervision, the Banking Supervision department also compiled data received from those institutions for future reference and for statistics purposes.

This year, the share of foreign bank branches and subsidiaries in total bank loans and deposits amounts to 27.24% and 31%, respectively. Banking activities increased, with many banks opening or requesting permission to open new branches in the capital city and provinces. In 2005, the banking system consisted of 47 branches and 19 head offices, compared to 35 branches and 17 offices in 2004.

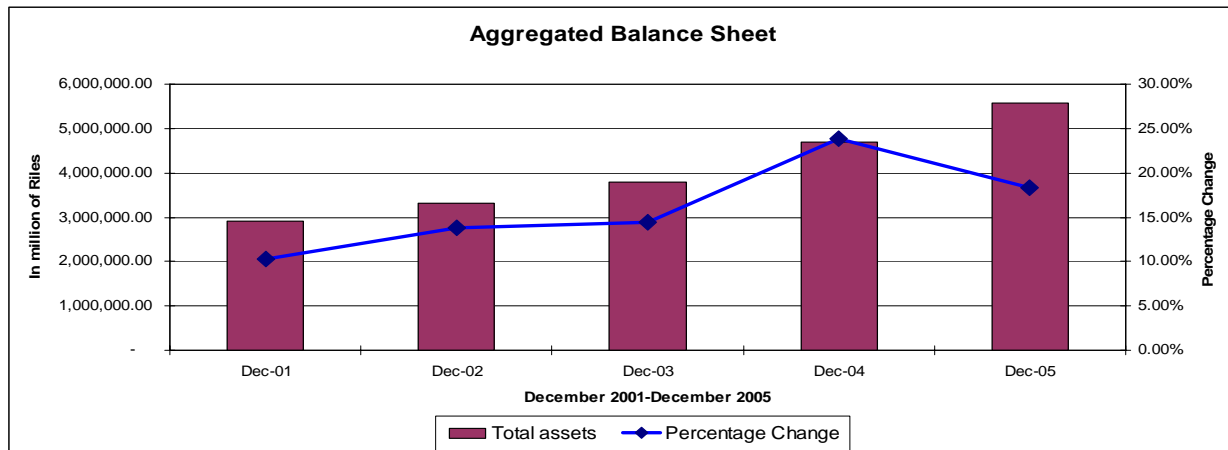
Bank deposits increased by 18% compared to the year 2004, while loans to the private sector

grew by 27.5%. The three sectors that benefited the most from the banking system were the service sector (33% of total loans outstanding) wholesale and retail (21.5%) and manufacturing (11%).

### 1.4.1.1 Balance Sheet Structure

The balance sheet structure is analyzed to determine the type and spread of a bank's business activities, as well as to consider the impact of changes on the risks profile of the banking sector. The aggregate balance sheet of the banking sector in Cambodia in 2005 was KHR 5,569,642.48, as compared to KHR 2,915,528.89 in 2001. The figure almost doubled over a period of four years.

**Figure 1: Aggregated Balance Sheet**

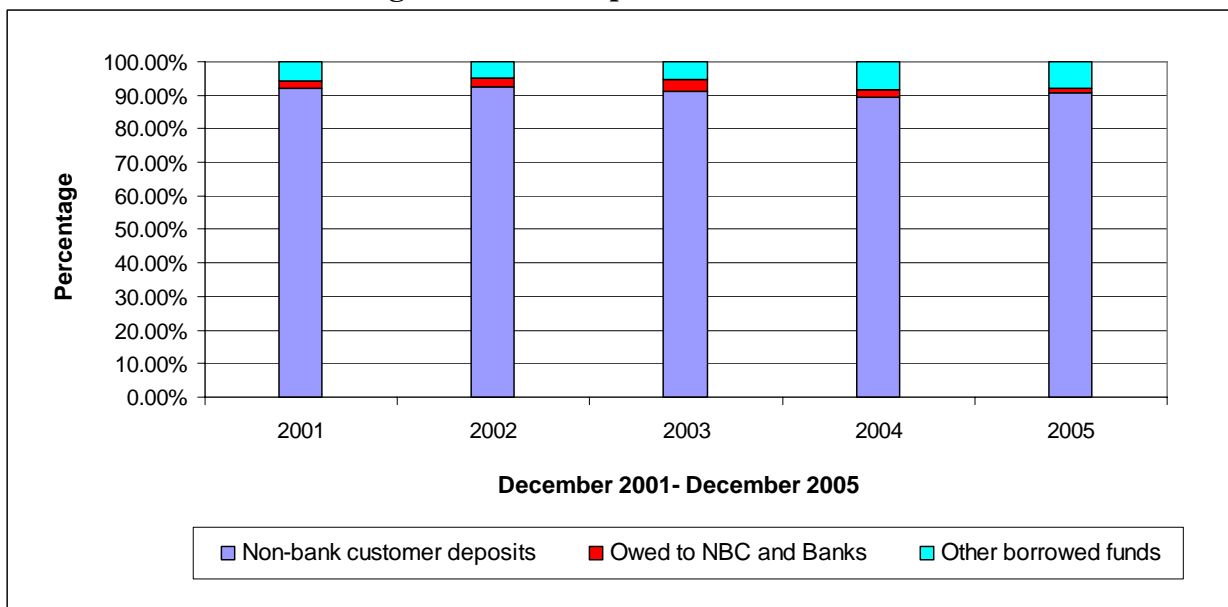


Source: Banking Supervision Department, National Bank of Cambodia

Figure 1 above graphically depicts the year end amount and percentage growth in the aggregate balance sheet of the banking sector for the period from December 2001 to December 2005. The aggregate balance sheet growth rate in 2001 was 10.26%; this increased gradually until 2004. By the end of 2005, it had dropped to 18.35%.

### Composition of Liabilities

**Figure 2: The composition of liabilities**

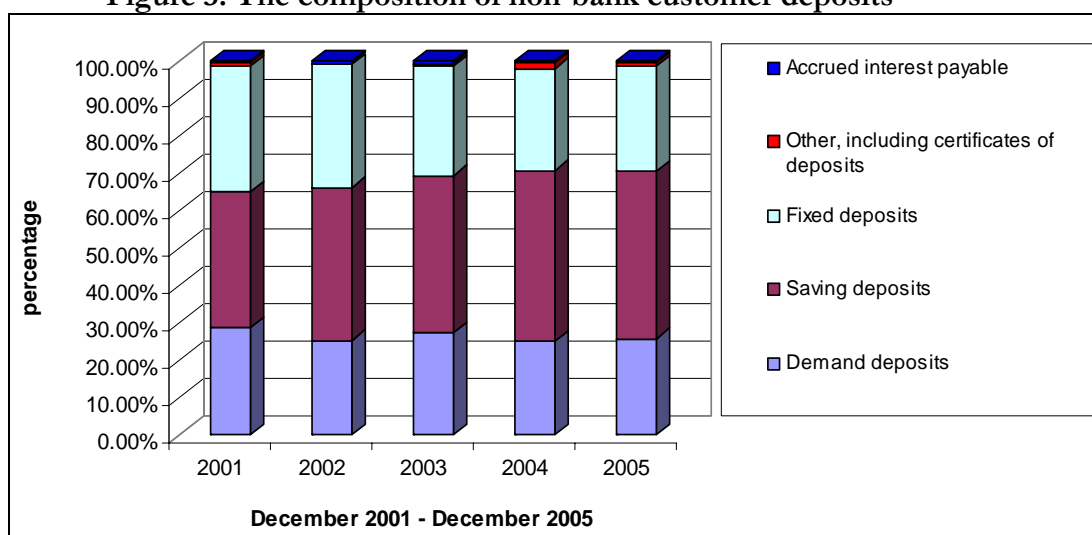


Source: Banking Supervision Department, National Bank of Cambodia

Figure 2 above shows the composition of liabilities in the banking system. The composition consists of non-bank customer deposit payments owed to National Bank of Cambodia and banks, and other borrowed funds. The ratio of non-bank customer deposits to total liabilities was over 90% during 2001-2005. This component had long been the main source of funds for the banking sector in Cambodia. The ratio of other liabilities fell within a range between 2% to 10% of total liabilities.

### *Composition of Non-bank Customer Deposits*

**Figure 3: The composition of non-bank customer deposits**

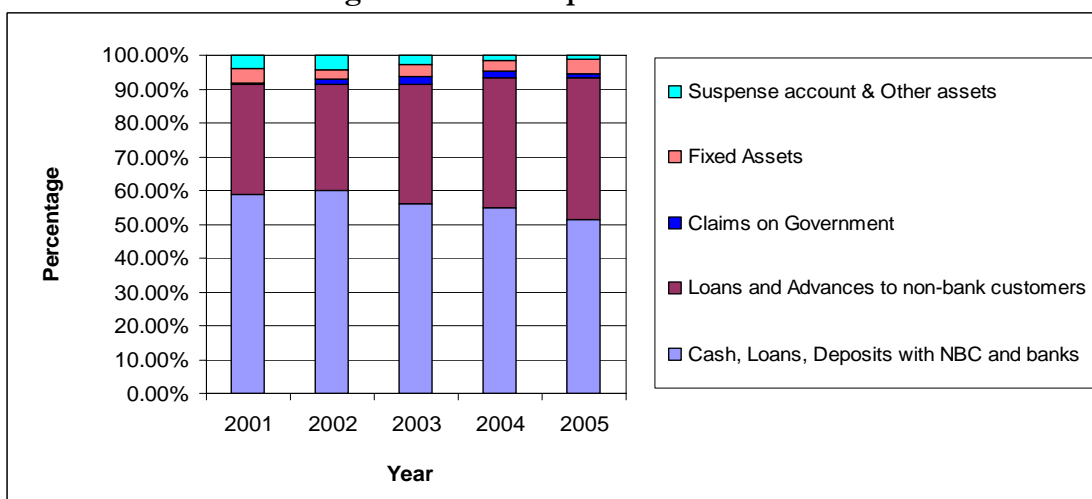


Source: Banking Supervision Department, National Bank of Cambodia

Figure 3 above shows the composition of non-bank customer deposits in banks during 2001-2005. Deposits include demand, fixed and savings deposits. As a percentage of total customer deposits, demand deposits decreased from 28.66% in 2001 to 25.69% in 2005. Savings deposit to total deposit decreased sharply from 36% in 2001 to 15% in 2005, while the ratio of fixed deposits to total deposits decreased continuously from 2001 to 2004 and rose slightly in 2005. The fixed deposit ratio was 33.56% and 28.09% in 2001 and 2005, respectively.

### *The Composition of Assets*

**Figure 4: The composition of assets**

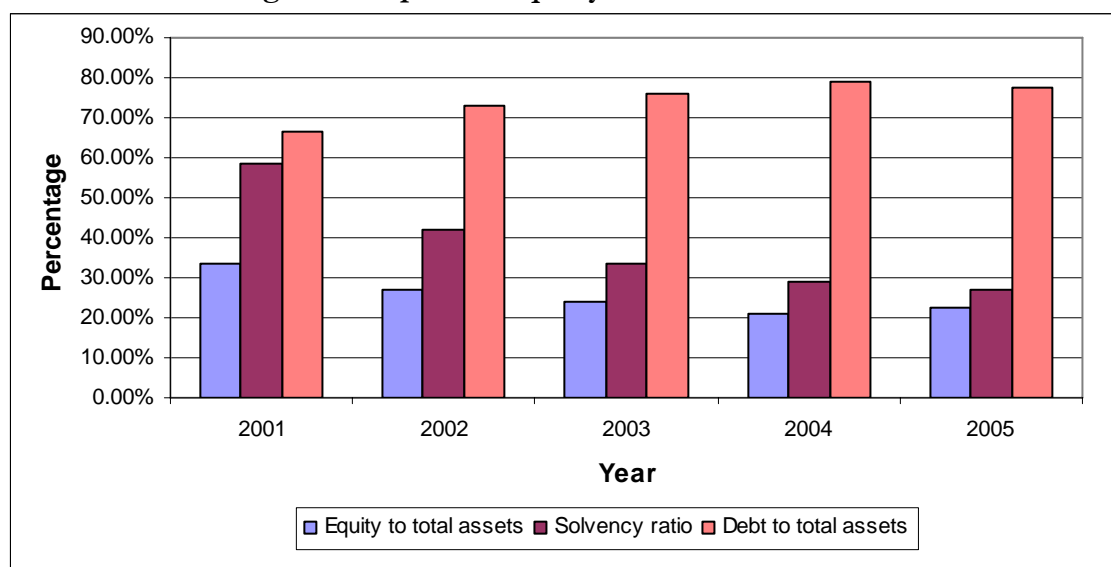


Source: Banking Supervision Department, National Bank of Cambodia

Figure 4 above depicts the composition of assets from 2001 to 2005. The main compositions of the assets are cash, loans and deposits with National Bank of Cambodia and banks, and the loans and advances to non-bank customers. As indicated in Figure 1, total assets (aggregated balance sheet) have increased. Components that contributed to the increase included placement with the central bank and loans and advances to non-bank customers. Cash, loans and deposits with National Bank of Cambodia and banks represented more than 52% of the total assets over 2001 to 2005. At the same time, loans and advances to non-bank customers represented between 30% and 45% of total assets.

### 1.4.1.2 Capital Adequacy

Figure 5: Capital Adequacy of Commercial Banks



Source: Banking Supervision Department, National Bank of Cambodia

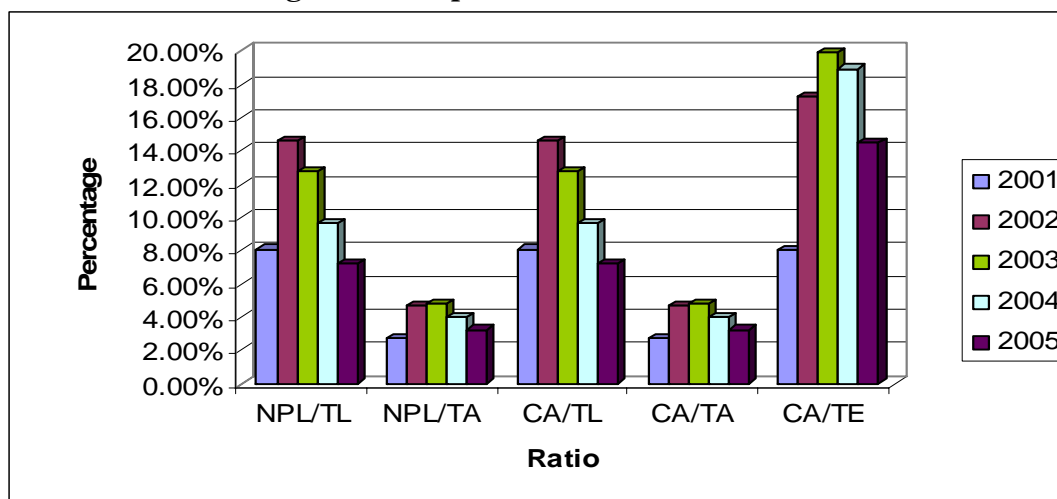
The banking sector in Cambodia showed strong capital adequacy in compliance with the regulation requiring a solvency ratio of 15%. The equity to total assets ratio decreased from 33.64% in 2001 to 22.37% in 2005. Meanwhile, the debt to total assets ratio increased from 66.36% to 77.63% during 2001-2005. Capital provides a safety net to depositors against losses that a bank might incur. For this reason, it is very important that banks have sufficient capital.

### 1.4.1.3 Asset Quality

#### *Composition of Classified Assets*

There are two categories of classified assets in the bank balance sheet: nonperforming loans (NPL) and (2) other assets for which specific provisions are made. Classified assets are considered at risk according to NBC *Prakas*. There are three categories of classified assets depending on past due payments and the financial condition of the counterparty: (1) substandard, (2) doubtful, and (3) loss. The composition of classified assets (CA) to total assets (TA) and to total equity (TE) is shown below. Compared to total loans (TL), nonperforming loans and classified assets reached their peak in 2002 and dropped gradually after that. Despite a slight drop in 2005, the ratio of classified assets to total equity remained at almost 15 percent, which was double that of 2001.

Figure 6: Composition of Classified Assets



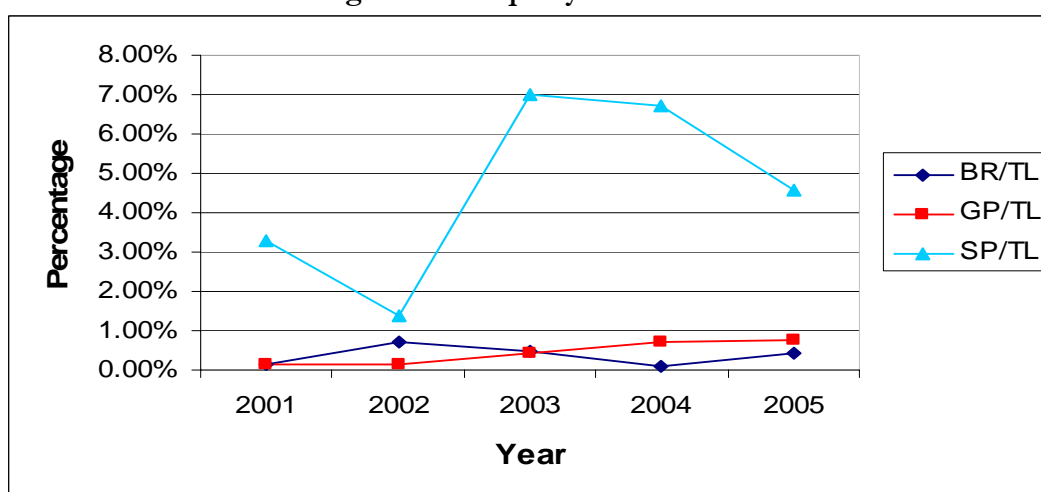
Source: Banking Supervision Department, National Bank of Cambodia

Note: NPL/TL: ratio of nonperforming loans to total loans  
 NPL/TA: ratio of nonperforming loans to total assets  
 CA/TL: ratio of classified assets to total loans  
 CA/TA: ratio of classified assets to total assets  
 CA/TE: ratio of classified assets to total equity

### Adequacy of Provision

To understand a bank's assets quality, it is important to review the adequacy of provision. Provision can be in the form of general or specific provision. Banks can also provide for systematic risks. General provision is made on the basis of total loan portfolio, while specific provision is made on the basis of loan classification. According to the regulation issued by the supervisory authority, loans can be classified as standard, substandard, doubtful, and loss. This classification requires banks to have a minimum of 10% for substandard, 30% doubtful and 100% for loss loans. This level of provision can be higher depending on the financial condition of the borrower. Figure 7 below shows the rate of banking reserve (BR), general provision (GP), and specific provision (SP) compared to total loans. On average this means that banks estimate that they need more provisions than the specific provisions required by the existing regulation.

Figure 7: Adequacy of Provision



Source: Banking Supervision Department, National Bank of Cambodia

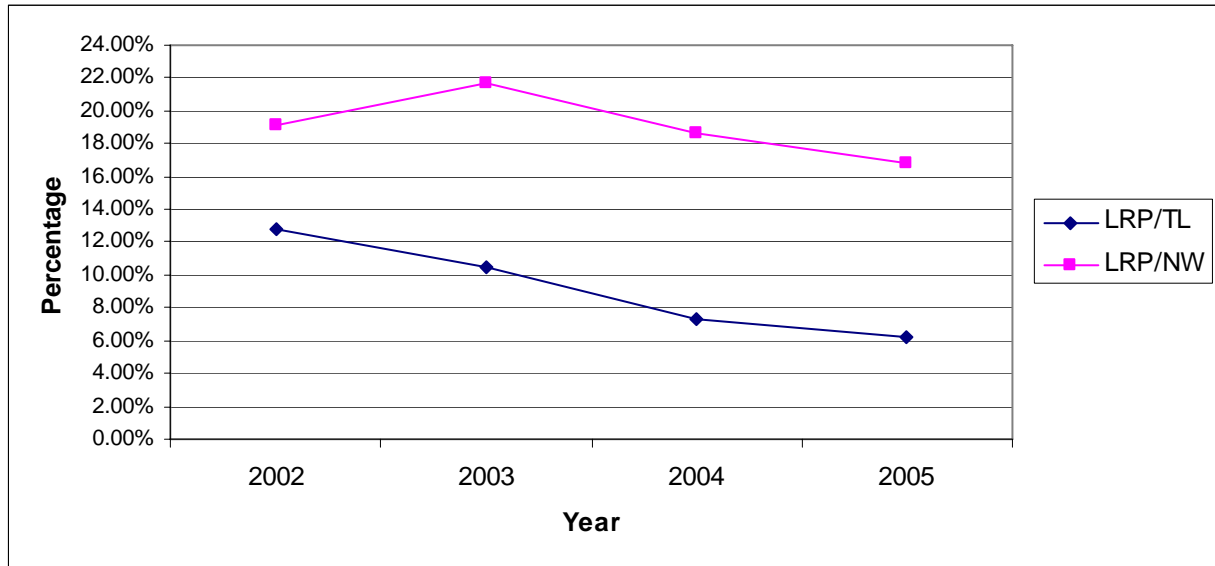
Note: BR/TL: ratio of banking reserve to total loans  
 GP/TL: ratio of general provision to total loans  
 SP/TL: ratio of specific provision to total loans



### *Related Party, Large Exposure Loans and Loan by sector*

Based on the prudential norms of the supervisory authority, banks should not extend loans to related parties and large exposure loans in excess of 10% and 20% of net worth, respectively. The figures below reveal large exposure loans (LE) and loans to related parties (LRP) as a percentage of total loans (TL) and net worth (NW).

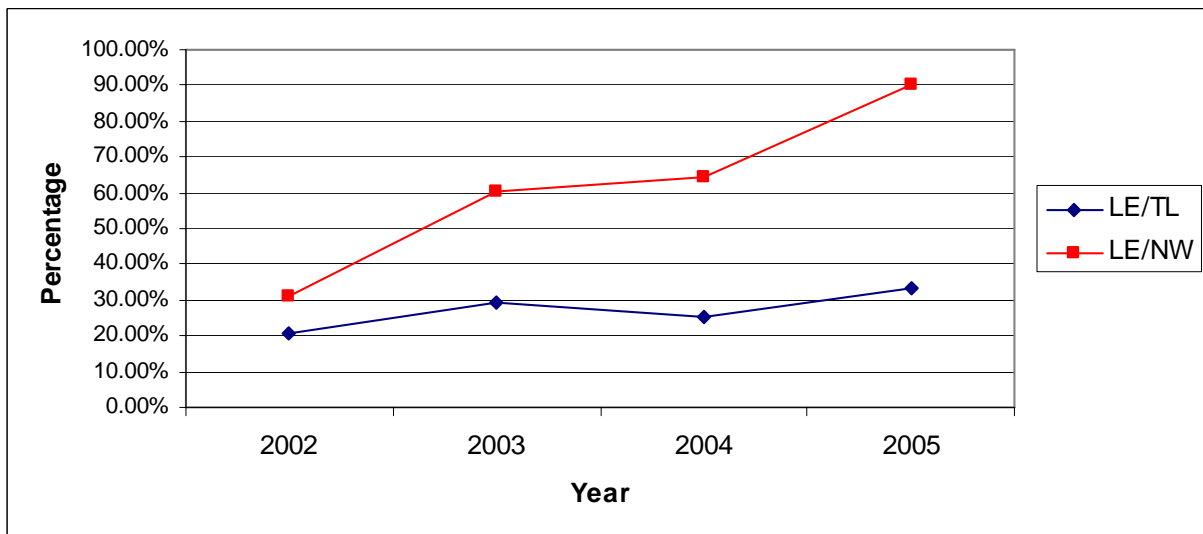
**Figure 8: Loans to Related Parties**



Source: Banking Supervision Department, National Bank of Cambodia

Note: LRP/TL: ratio of loans to related parties to total loans  
LRP/NW: ratio of loans to related parties to net worth

**Figure 9: Large Exposure Loans**



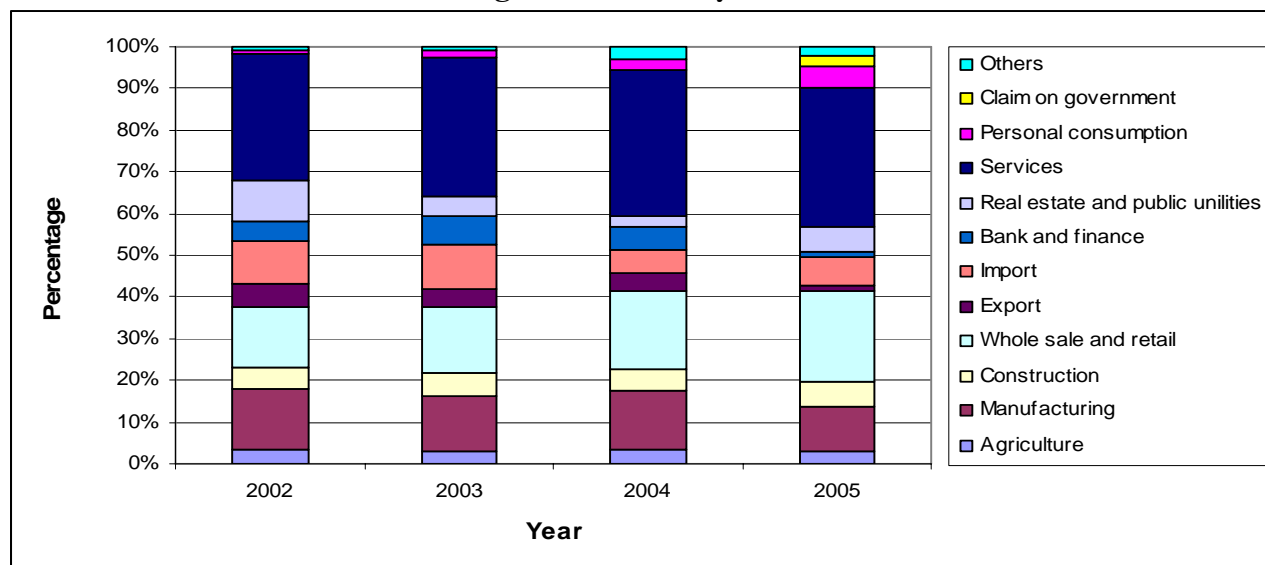
Source: Banking Supervision Department, National Bank of Cambodia

Note: LE/TL: ratio of large exposure loans to total loans  
LE/NW: ratio of large exposure loans to net worth

The NBC is addressing the issue of related party lending, which has slightly diminished over the past few years, but which remains a serious concern to bank supervisors.

Figure 9 illustrates the increase of large exposures that raised from 30.92% of the networth in 2002 to 90.41% in 2005. Several waivers have been granted by the NBC for exposures guaranteed by parent bank's benefiting from a sufficient international rating (investment grade).

Figure 10: Loans by Sector



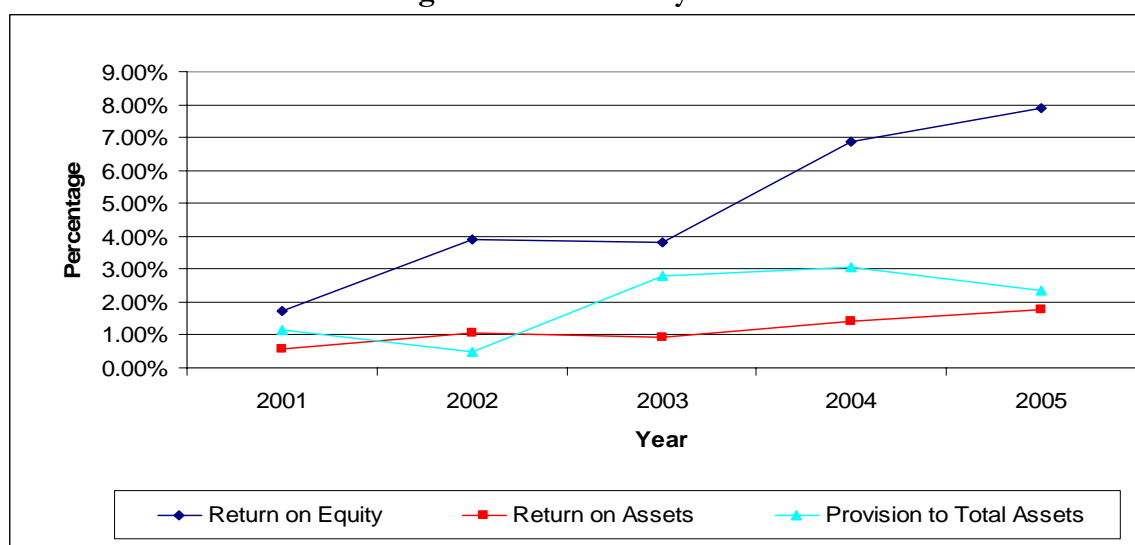
Source: Banking Supervision Department, National Bank of Cambodia

Most loans were provided to service industries which were around 33% of the total loans while loans to whole sales and retails increase from 14.51% in 2002 to 21.50% in 2005. Loan to manufacturing industries is around 14% of total loans and declined to 10.95% in 2005.

### 1.4.1.4 Earnings

Since the completion of bank restructuring in 2000, the financial sector, especially the banking industry, has gradually expanded. As a result, customer deposits and loans and advances to customers have increased. As illustrated in the figure below, the return on equity (ROE) of the global banking industry increased rapidly from 1.73% in 2001 to 7.87% in 2005. Return on assets (ROA) increased from 0.58% in 2001 to 1.76% in 2005. In addition, the trend of non-interest income has increased yearly. This reflects the improvement of banking services in Cambodia. Despite such improvement, the profitability of banks is globally weak, as ROA and ROE remains low.

Figure 11: Profitability Ratio



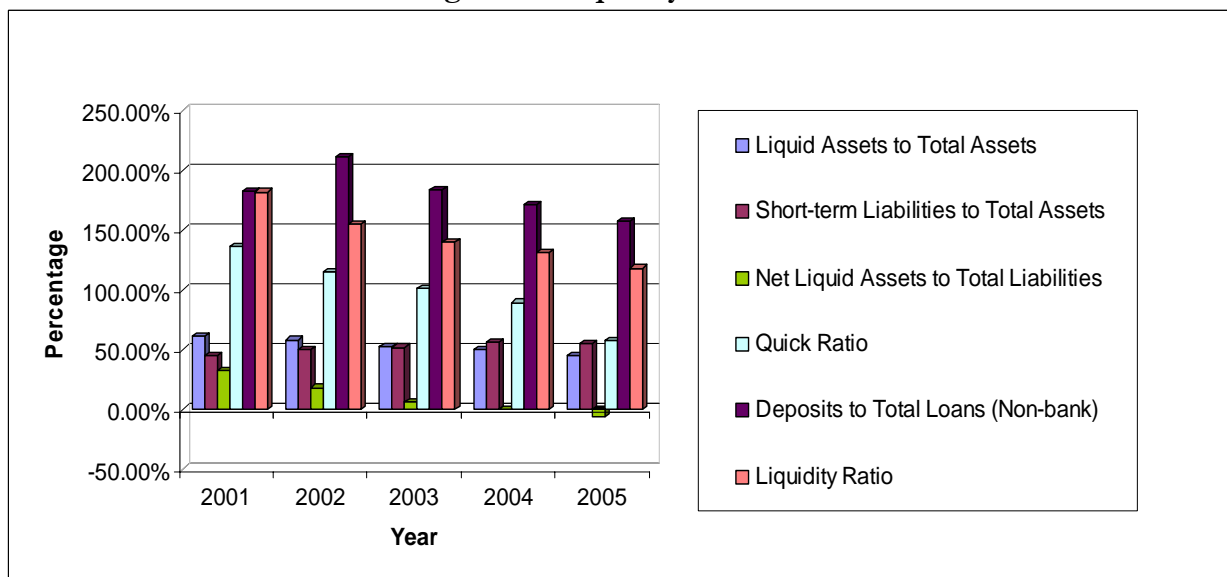
Source: Banking Supervision Department, National Bank of Cambodia

### 1.4.1.5 Liquidity

Liquidity is an important factor in ensuring the stability of the financial sector. Banks require an adequate stock of liquid assets to fulfill both expected and unexpected cash demands made by the depositors, particularly cash withdrawals at very short notice.

Since a growing proportion of deposits were used by banks to grant loans to their customers, the liquidity of the Cambodian banking system decreased gradually from 2001 to 2005, except for the short-term liabilities to total assets ratio. As seen in Figure 12, the liquidity ratio of the banks is higher than the required minimum, 50% as required by *Prakas B7.04-207 Prokor* on amendment of *Prakas* relating to liquidity for banks and financial institutions.

Figure 12: Liquidity Indicators



Source: Banking Supervision Department, National Bank of Cambodia

\* The liquidity ratio requirement was amended to 80% as of June 2002, and to 50% as of December 2004

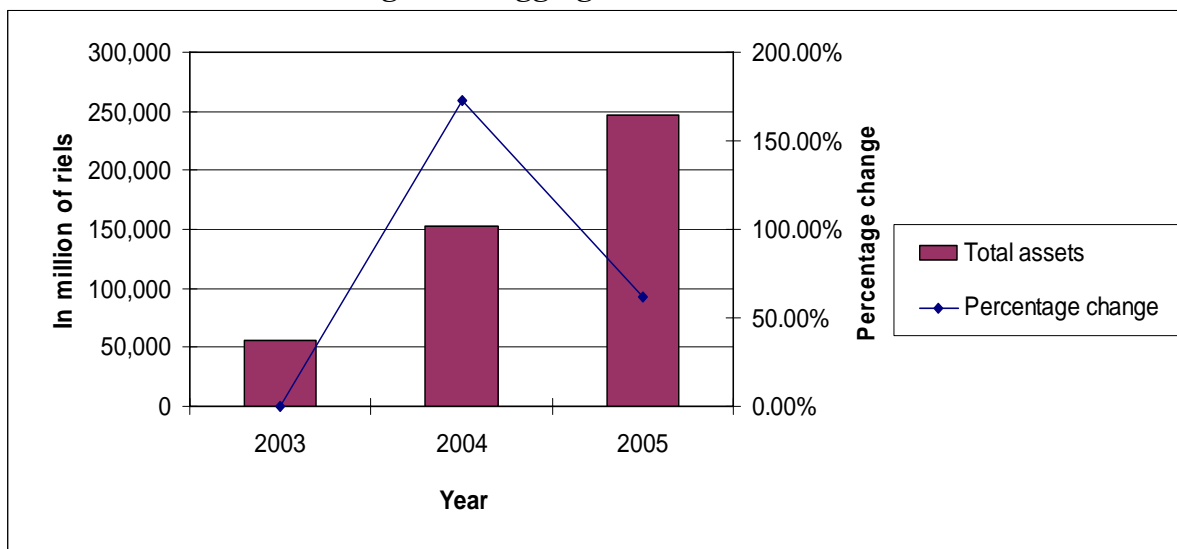
### 1.4.2 Microfinance Institutions

Registered microfinance operators and licensed microfinance institutions shall submit regular reports to the National Bank of Cambodia with regard to their financial results, their loan portfolio, the deposits they mobilize and their network of branches and offices. Every quarter, registered microfinance operators must prepare reports to be submitted to NBC within one month of the end of each quarter. Every month, licensed microfinance institutions must prepare reports to be submitted to NBC within 15 days of the end of each month.

#### 1.4.2.1 Balance Sheet Structure of MFIs

The aggregated balance sheet of the microfinance sector in Cambodia in 2005 equaled KHR 247 billion, compared to KHR 152 billion in 2004, and to KHR 55 billion in 2003.

**Figure 13: Aggregated Balance Sheet**

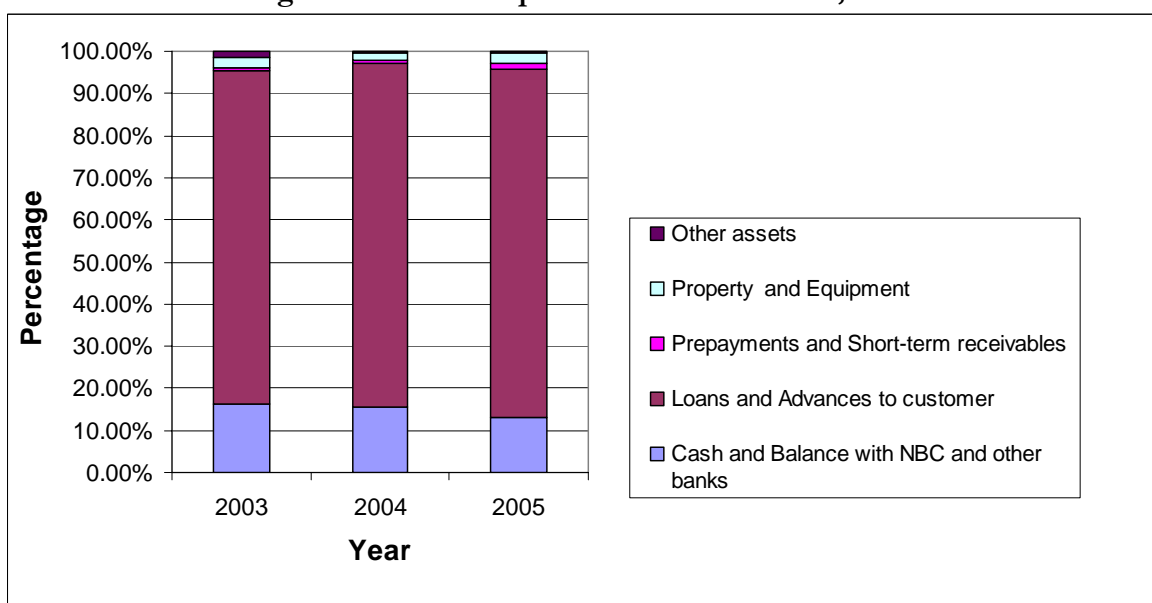


Source: Banking Supervision Department, National Bank of Cambodia

Figure 13 illustrates the year-end amount of and the percentage of growth in the aggregated balance sheet of the microfinance sector for 2003-2005. The growth rate in 2004 was 172%; it slowed to 62% in 2005.

**Composition of Assets**

**Figure 14: The Composition of Total Assets, MFIs**

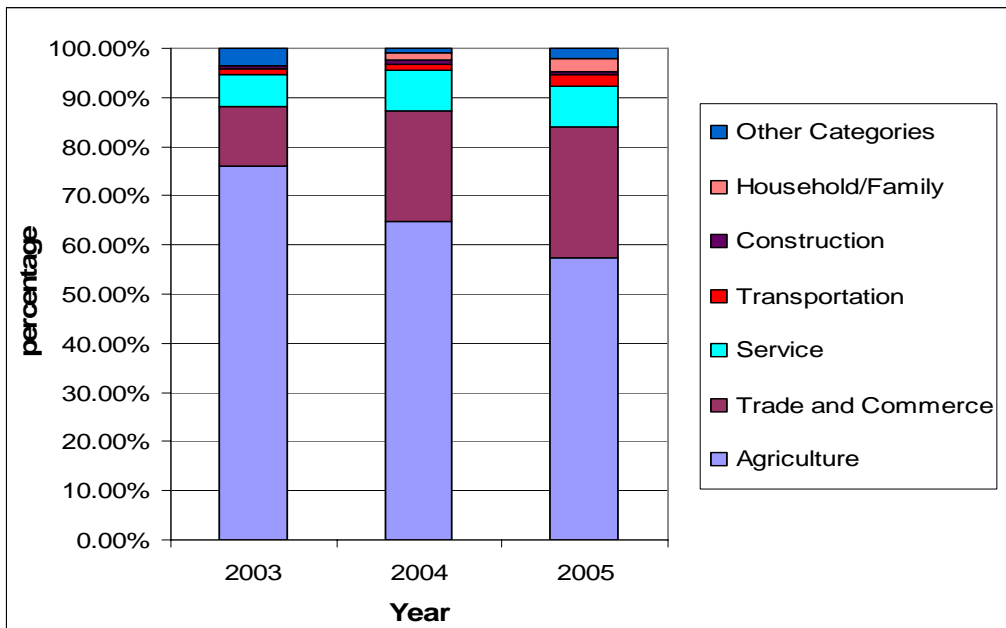


Source: Banking Supervision Department, National Bank of Cambodia

Figure 14 shows the asset composition of the microfinance sector from 2003 to 2005. The main assets are cash and balance with the National Bank of Cambodia and other banks, loans and advances to customers, prepayments and short-term receivables, property and equipment, and other assets. Cash and balance with National Bank of Cambodia and other banks comprised 16% of total assets in both 2003 and 2004, while it decreased to 13% in 2005. Loans and advances to customers represent the major part of assets: approximately 79% to 83% of total assets.

*Composition of Loans to Customers*

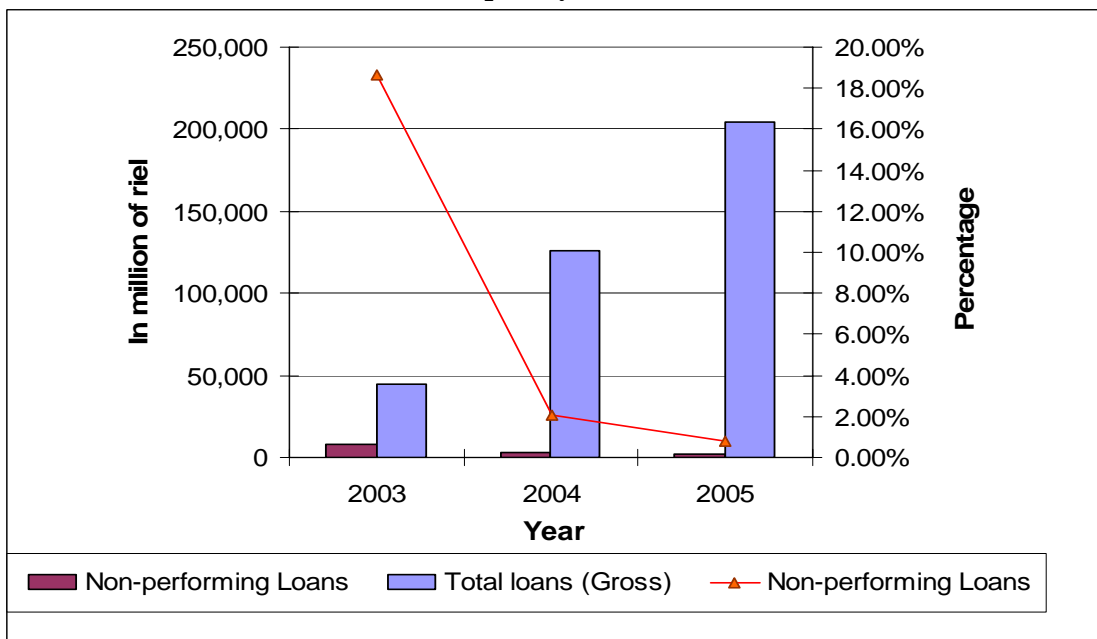
**Figure 15: Composition of Loans to Customers, MFIs**



Source: Banking Supervision Department, National Bank of Cambodia

MFI loans were provided principally to the agriculture sector more than 50% of total loans.

**Figure 16: Trends of Non-performing Loans, Total Gross Loans, and Delinquency Ratio of MFIs**

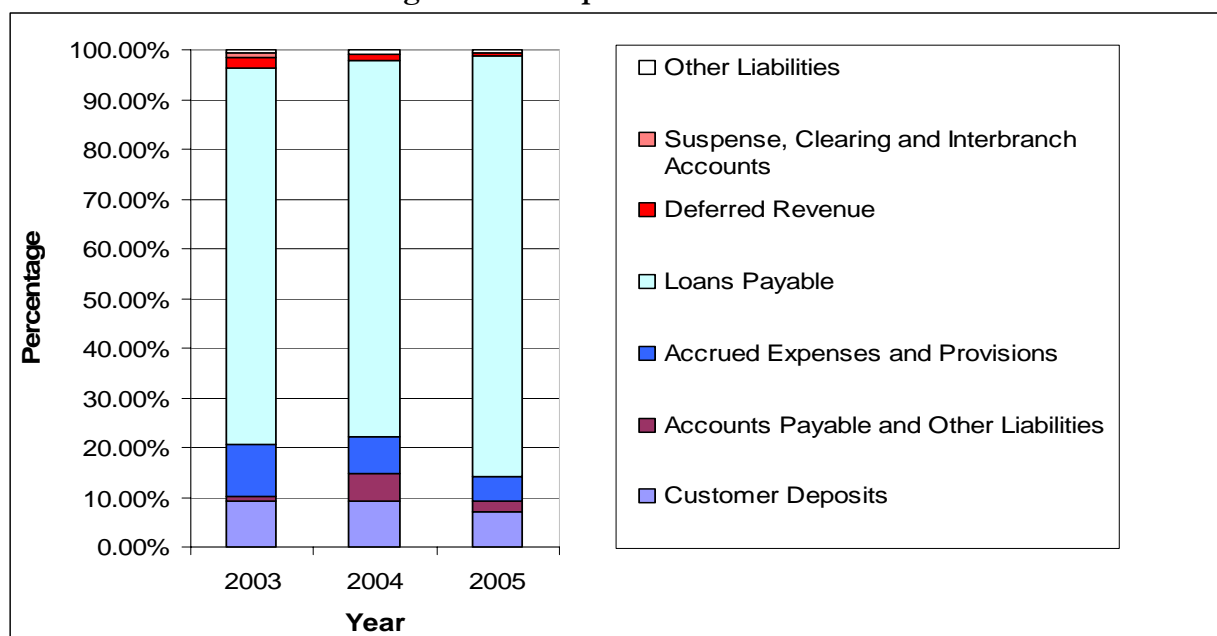


Source: Banking Supervision Department, National Bank of Cambodia.

Total gross loans of MFIs increased sharply in 2004. It increased by 183% in 2004, and by 62% in 2005, whereas non-performing loans decreased by 68% and 39%, respectively. The delinquency ratios of MFIs in 2003, 2004, and 2005 were 19%, 2%, and 1%, respectively.

### Composition of Liabilities

Figure 17: Composition of Liabilities

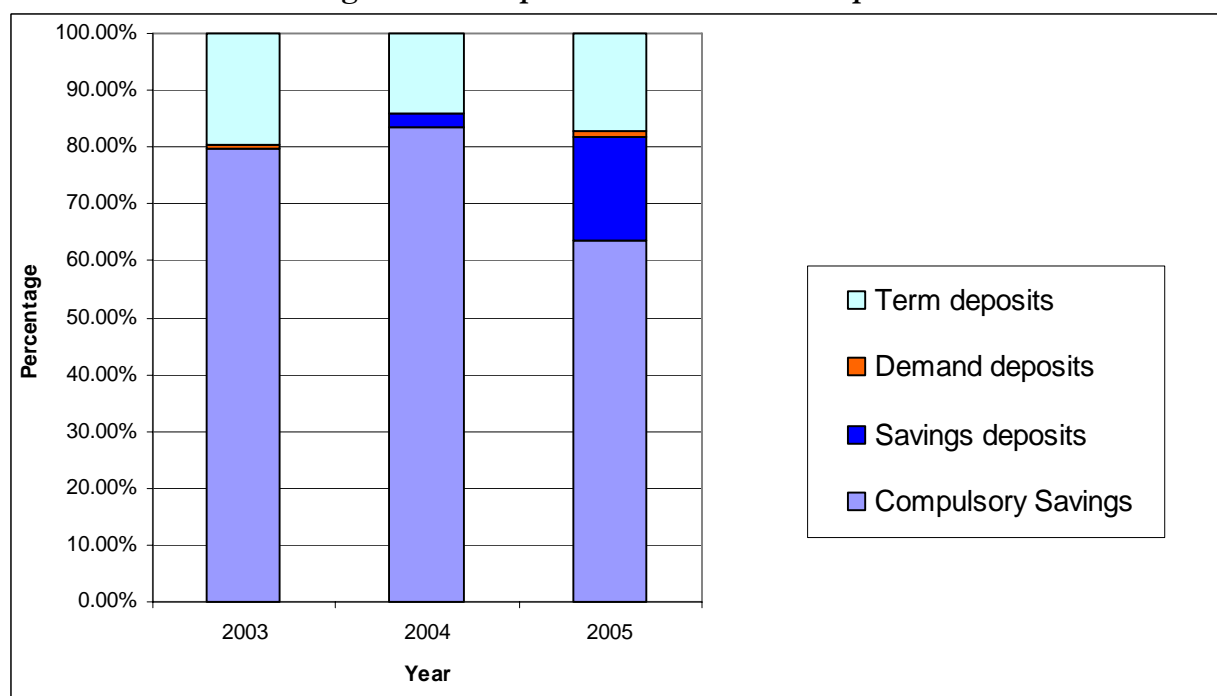


Source: Banking Supervision Department, National Bank of Cambodia

Figure 17 showed that loans payable to total liabilities ranged from 76% to 84% during 2003-2005.

### Composition of Customer Deposits of MFIs

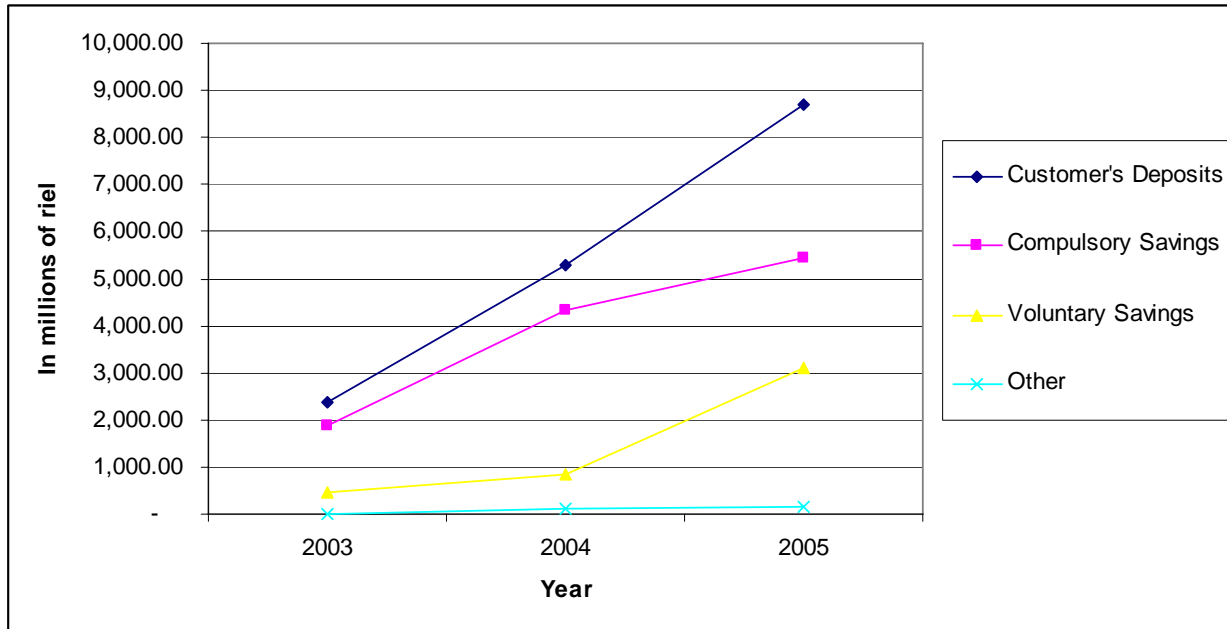
Figure 18: Composition of Customer Deposits



Source: Banking Supervision Department, National Bank of Cambodia

Compulsory savings was the main component of customer deposits. It made up between 60% to 83% of customer deposits during 2003-2005.

**Figure 19: Trend of Customer Deposits of MFIs (In millions of riel)**



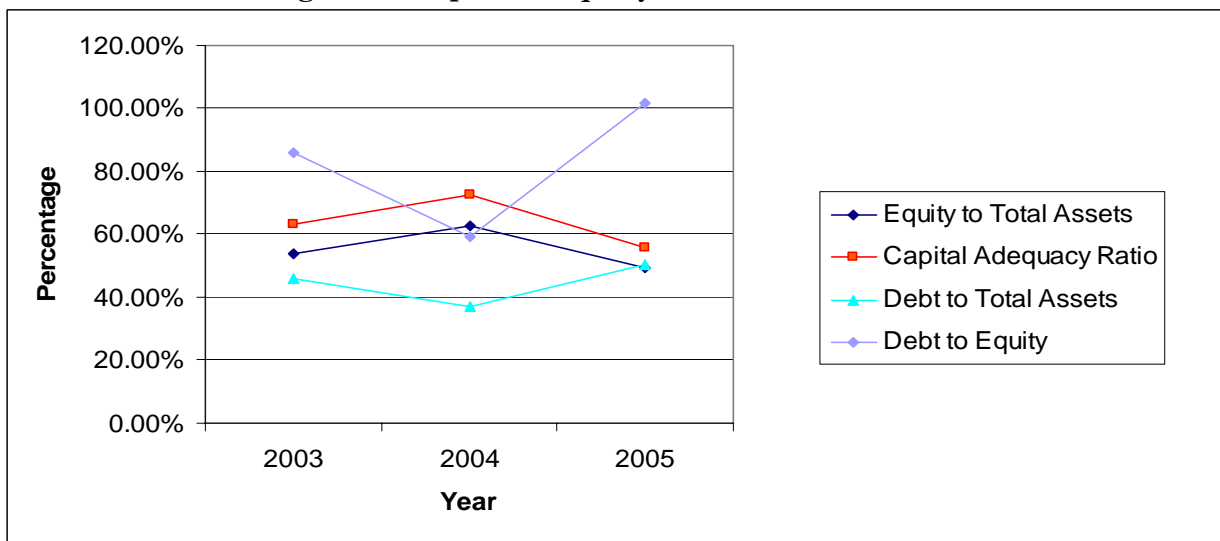
Source: Banking Supervision Department, National Bank of Cambodia

In 2005, MFIs total customer deposits were KHR 8,703 million. Customer deposits increased by 125% in 2004 and by 64% in 2005. Customer deposits consisted of compulsory and voluntary savings. In 2004, compulsory savings increased by 131%, while voluntary savings increased by 26%. In 2005, compulsory savings increased by 82%, while voluntary savings increased by 262%.

### 1.4.2.2 Capital Adequacy

In 2003, 2004, and 2005, the capital adequacy ratios were 63%, 73%, and 56%, respectively. The ratios increased by 17% in 2004 and decreased by 21% in 2005.

**Figure 20: Capital Adequacy of Microfinance Sector**

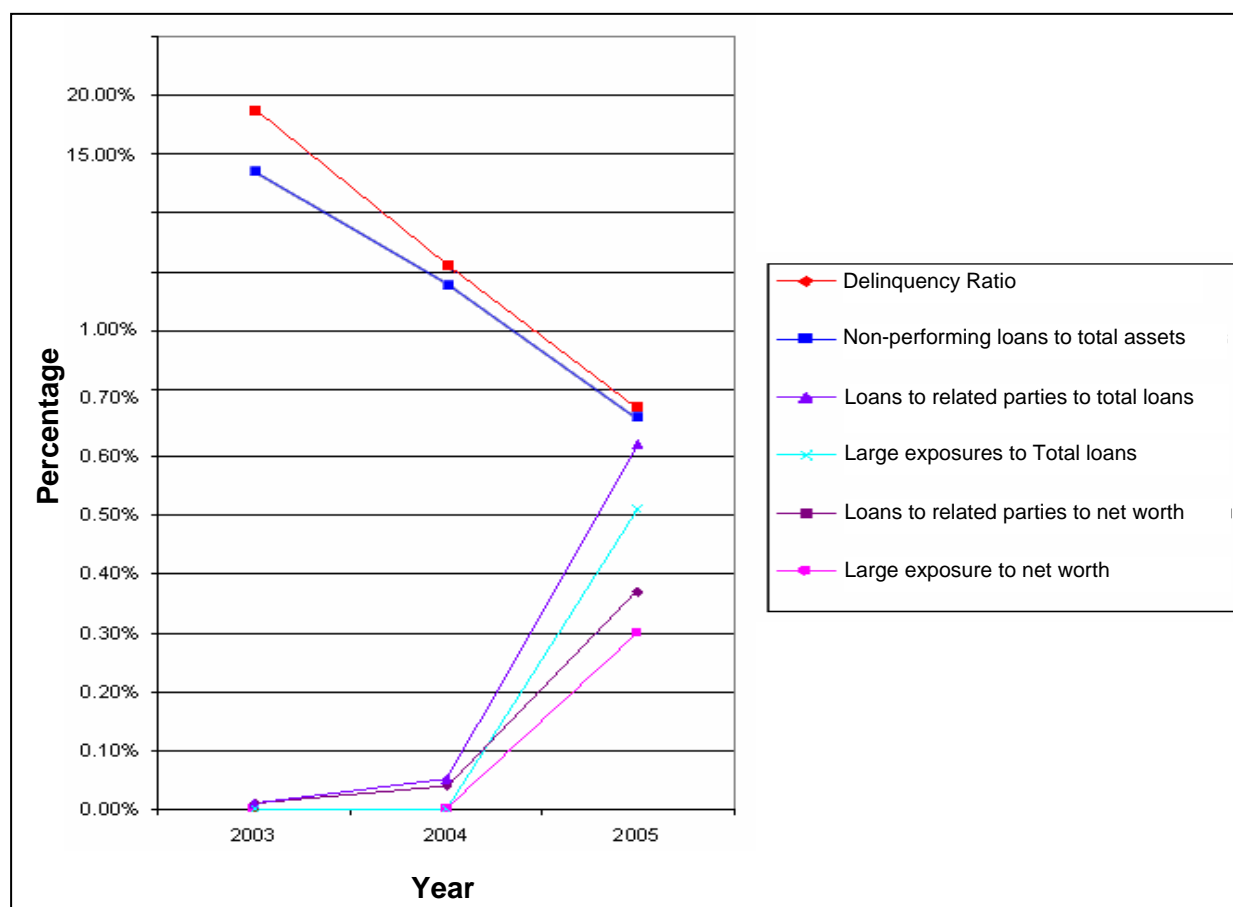


Source: Banking Supervision Department, National Bank of Cambodia

### 1.4.2.3 Asset Quality

In 2003, 2004, and 2005, delinquency ratios were 19%, 2%, and 1%, respectively. The ratios decreased by 89% in 2004, and by 63% in 2005. MFIs have almost no loans to related parties and have no large exposure loans. The delinquency ratio is the ratio of total loans past due more than 30 days and total loans outstanding. This ratio is a key indicator of the quality of a loan portfolio. Its increase from one period to the next is a significant early warning signal of serious problems to come. The aggregate exposure to insiders and related parties shall not exceed 10% of net worth. The large exposures ratio is set at 10% of net worth. Furthermore, loan commitment aggregate to an individual borrower or to a group of borrowers constituting a single beneficiary due to connections among themselves shall not exceed 10% of net worth. Microfinance institutions had large exposure only in 2005; it equaled 0.30% of total loans, and 0.51% of net worth. Similarly, loans to related parties to total loans ratio and loans to related parties to net worth ratio was less than 1%.

Figure 21: Asset Quality of Microfinance Sector



Source: Banking Supervision Department, National Bank of Cambodia

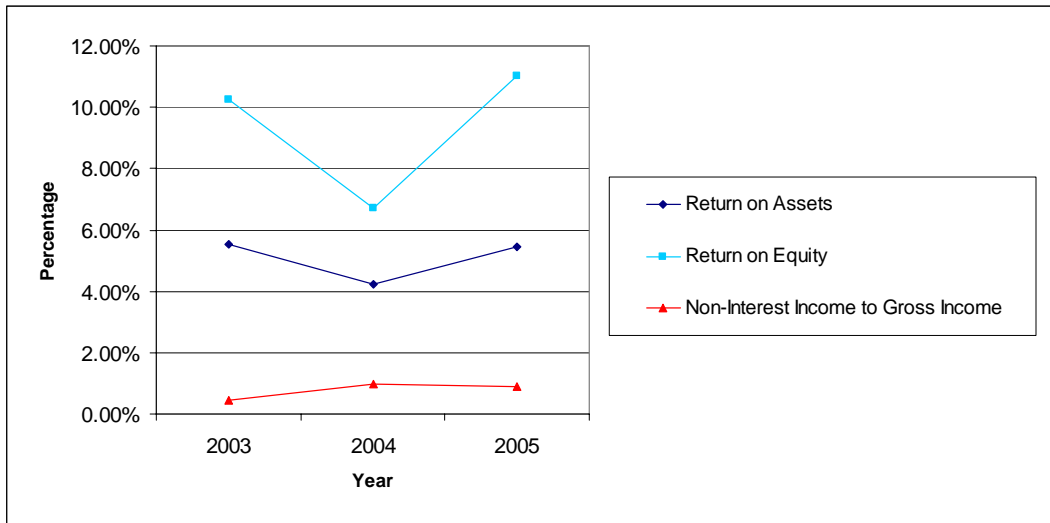
### 1.4.2.4 Earnings

Net profits of MFIs increased sharply. In 2004, it increased by 108%; in 2005, by 110%. Return on equity decreased by 34% in 2004, but increased by 64% in 2005. Return on assets decreased by 24% in 2004, and increased by 29% in 2005. Earnings of MFIs were enough to cover interest



expenses. Return on assets (ROA) and return on equity (ROE) are naturally higher than in the banking sector. However, both ratios remained relatively low.

**Figure 22: Earnings of the Microfinance Sector**

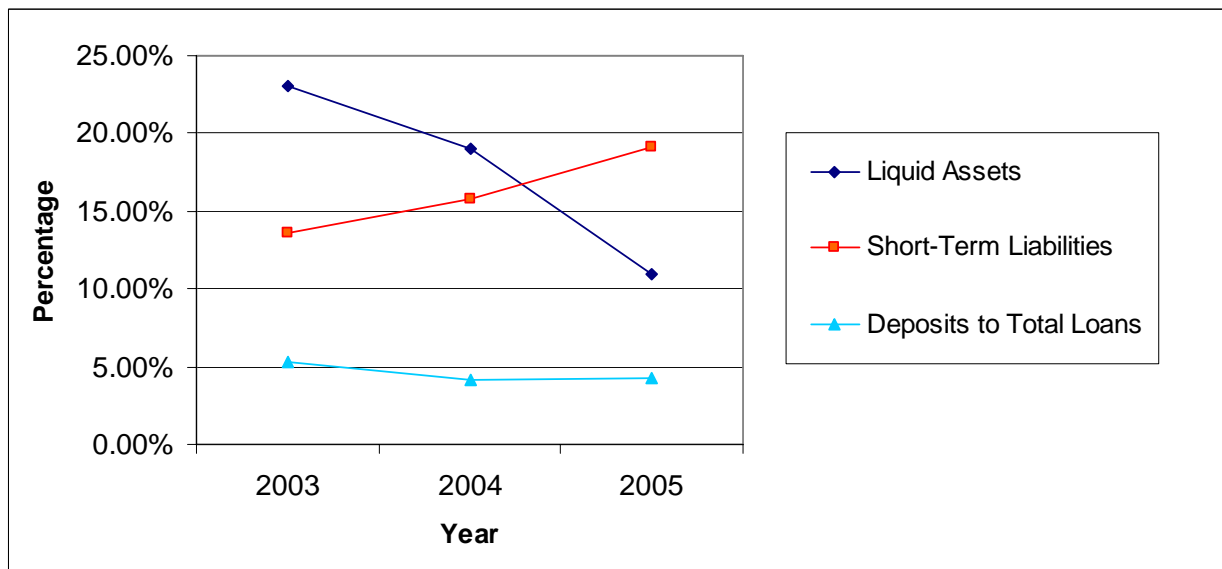


Source: Banking Supervision Department, National Bank of Cambodia

#### 1.4.2.5 Liquidity

In 2003, 2004 and 2005, liquidity ratios were 10738%, 13810%, and 3630%, respectively. According to the liquidity ratio, MFIs look to be very liquid, but only a small proportion of loans have been funded with deposits. Total deposits to total loans decreased by 20% in 2004, but it increased by 1.31% in 2005. The microfinance sector had high liquidity because its assets were mostly short-term assets and it had fewer deposits.

**Figure 23: Liquidity of Microfinance Sector**



Source: Banking Supervision Department, National Bank of Cambodia

## 2. BANKING SUPERVISION DEPARTMENT

The Banking Supervision department has many duties and responsibilities to strengthen the banking system and protect the public interest. To achieve this goal, the Banking Supervision Department implemented the strategy of the Financial Sector Blueprint.

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 addresses relevant sub-sectors to be developed within the period of 2001 to 2010.



The Financial Sector Blueprint requires the Banking

Supervision department to implement changes in the banking sector. Now halfway through the period, some tasks have been completed, such as establishing a framework for supervision and restructuring the banking sector. We will continue to implement to the Financial Blueprint, which will soon be updated in order to enhance the intermediation of banking sector through increased competition that will diversify banking services, leading to increased outreach to the poor and to rural areas. This increased outreach will promote efficiency within the banking system through the reorganization of the banking industry and further integration. The Banking Supervision department's objectives are the following:

	(2005-2007)	(2008-2010)
<b>Supervision and Prudential Regulations</b>	<p><i>Improve enforcement of prudential regulations</i></p> <ul style="list-style-type: none"> <li>- Strengthen the implementation of Prompt Corrective Action (PCA).</li> <li>- Continue full on-site inspections by NBC staff.</li> <li>- Establish legal and regulatory framework and procedures for banks to Merge &amp; Acquire and Purchase &amp; Acquire.</li> <li>- Establish a transparent exit mechanism and streamline exit procedures.</li> <li>- Establish legal protection for supervisors against lawsuits for actions taken in fulfilling official duties.</li> </ul>	<p><i>Upgrade prudential regulations</i></p> <ul style="list-style-type: none"> <li>- Refine prudential norms in full compliance with the BIS guideline.</li> <li>- Strengthen risk management regulations with the expansion of non-banking business of banks.</li> </ul>

<b>Banking Industry and Competition</b>	<i>Enhance banking services through diversification of banking businesses</i> <ul style="list-style-type: none"> <li>- Diversify the scope of business by allowing banks to expand their business into other non-banking sector.</li> <li>- Help banks set up non-bank financial institution (NBFI) subsidiaries.</li> <li>- Establish legal and regulatory framework for consumer finance.</li> <li>- Create regulatory framework for banks to undertake credit card service, housing/mortgage finance, installment finance, etc.</li> </ul>	<i>Facilitate bank reorganization through incentive and reinforced supervision</i> <ul style="list-style-type: none"> <li>- Establish an incentive system for promoting voluntary bank to Merge &amp; Acquire and Purchase &amp; Acquire.</li> <li>- Reinforce minimum capital requirement for banks involved in diverse non-banking businesses.</li> <li>- Strengthen PCA to facilitate early and orderly exit of non-viable banks.</li> </ul>
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In order to achieve the above targets, the Banking Supervision department must have clearly defined roles and functions. Each of these roles and functions is divided into sections and divisions and implemented as follows:

## 2.1. Roles and Functions of the BSD and its tools for achieving its goals

The Banking Supervision department operates through off-site supervision and on-site inspection of banks and microfinance institutions (MFIs). (Appendix 2)

### 2.1.1 Off-Site division

In order to strengthen the banking system and protect the interests of the public, the Off-Site division has the duties of supervising and monitoring commercial banks' compliance with prudential regulations through reviewing financial statements to detect any illegal transactions. The sanctioning



and/or de-licensing of commercial and specialized banks occur when periodic financial statements reveal substantial risks. Usually, a warning is issued first. The Off-Site supervision works closely with its On-Site counterpart and advises any suspicious transactions for the On-Site team to follow up on.

The division has three sections: (1) Information Management, which is responsible for inspecting and organizing all bank documents, (2) Micro Analysis, which is responsible for analyzing a bank's financial condition; and (3) Macro Analysis, which is responsible for analyzing the financial condition of the banking system.

### ***Uniform Chart of Account Implementation***

Because each bank has a different chart of account, the National Bank of Cambodia issued a *Prakas*, dated 25 December 2002, requiring all commercial banks to implement the **Uniform Chart of Account** from 1 January 2003.

In order to facilitate the process of implementation, the National Bank of Cambodia has classified banks into three categories based on the volume and sophistication of their transactions. On-site inspections were performed to verify the variability of existing banks. As a result, all commercial banks were in full compliance with the Uniform Chart of Account by the end of 2004.

### ***Bank Performance Report***

After all banks fully complied with the Uniform Chart of Account, the Off-Site division devised a *Bank Performance Report* aimed at analyzing a bank's financial condition through reports directly generated by the Off-Site division computer system.

To date, the Off-Site division is in the process of creating *Off-Site Surveillance System*, which consists of a *Bank Performance Report*, prudential regulation statements, and other information. The system helps the Off-Site division analyze a bank's financial situation, to follow up the implementation of prudential regulations of the bank, and to protect and detect any risks or any errors of the bank more effectively. From now on, every bank supervisor will use this system to analyze a bank's statement. The supervisor will then summarize his findings and recommendations in a COBRA report to be submitted to his superiors in the department.

#### **2.1.2 On-Site division**

The role and function of the On-Site division is to further analyze irregularities identified by the Off-Site Supervision division, prepare a program and strategies for on-site inspection of banking institutions, carry out on-site inspections, and prepare a inspection report. Other duties include



evaluating the quality of the management and financial position of each bank and cooperating with the Off-Site inspection division to propose actions or penalties to the administration, research, regulation and licensing divisions.

In the year 2005, thirteen commercial banks were inspected by the On-Site inspection team, eleven of which were full-scope examinations; and two were targeted examinations. The inspections were performed using the CAMELS method (Capital, Asset,

Management, Earning, Liquidity, and Sensitivity to Market Risk). As the result of the inspections, some banks have shown difficulties in complying with regulations. A number of prompt corrective actions have been sent out to underachieving banks.

The On-Site inspection team prepared an On-Site inspection plan for the year 2006 with the purpose of setting up more effective inspection activities. Furthermore, the inspection teams monitor the recommendations given to inspected banks. In the follow-up action, the teams review the action plans prepared by banks to resolve problems discovered by the inspection teams.

### 2.1.3 Microfinance Institutions Division

The Microfinance Institutions Supervision division is divided into three sections: Registration and licensing; Off-Site supervision; and On-Site supervision. The division is responsible for studying applications for licensing and registration, renewal and revocation of license, and registration of microfinance operators. Similar to the Off-Site division and On-Site division, the Microfinance Institutions Supervision division is also responsible for conducting off-site and on-site inspections of microfinance institutions to ensure transparency in implementing the laws and regulations of the National Bank of Cambodia and to give early warnings of potential problems affecting supervised microfinance institutions.

Under the Law on Banking and Financial Institutions, non-governmental organizations operating micro credit are required to obtain a license or be registered at the National Bank of Cambodia. To date, many NGOs have been transformed into licensed and registered microfinance institutions. Among them, 16 NGOs have become licensed MFIs and 23 are now registered with NBC as rural credit operators.



To strengthen the microfinance institutions sector, the National Bank of Cambodia has prepared a *Prakas* on the establishment of a savings community. The purpose of this *Prakas* is to improve members' socio-economic conditions through sound promotion of community savings based on common bonds and to contribute to the development of the regional economy by providing a full array of financial services to community residents.

### 2.1.4 Licensing and Regulation Division

The Licensing and Regulation division is responsible for all letters, documents, studies, reviews on *Prakas* and circulars, documents for bank licensing applications, and the monitoring and follow-up of implementations set by the Banking Supervision Department, as well as recommending whether to issue or withdraw banking licenses. However, the Banking Supervision department has established a working group to monitor and review *Prakas* and circulars that the National Bank of

Cambodia has issued, including some *Prakas* amendments. The purpose of the review is to establish an updated version of all regulations to be published on NBC's website. In 2005, the division prepared one

*Prakas* and four circulars for banks and financial institutions to implement. Moreover, the division participated in the drafting of the *Law on Leasing and Code of Conduct* and *Prakas of Credit Information Sharing System*. This division is also responsible for studying bank applications in accordance with *Prakas* No.B7.00-04 (Licensing of Banks).



The operating license for a commercial bank shall be issued in two stages:

- The "approval in principle" is approval

for conducting preparations for the establishment of a commercial bank subject to proof of fully paid up capital of 100 percent and opening accounts for deposit guarantees which is blocked by the NBC. The deposit guarantee is 10 percent of registered capital for a commercial bank and 5 percent for specialized bank.

- The operating license is a license issued to allow conducting business after the "approval in principle" has been completed and NBC conditions have been fulfilled.



In 2005, the division studied the application of First Investment Specialized Bank, issued a letter of "approval in principle" to Cambodia Banking Corporation Ltd., and a letter to recognize Angkor Viniyuk CAN-CAM auditor as a new audit firm.

## 2.2 Strengthening the partnership with the private sector

In line with Royal Government policy, NBC recognizes the creation of ABC (Association of Banks in Cambodia) and its subordinate CMA (Cambodian Microfinance Association) by allowing them to give feedback on any issues, from prudential regulations to other administrative matters in a yearly private sector forum, including the services and banking and finance sectors, and between government institutions and the private sector.



As part of NBC's consultative approach, we constantly seek feedback and comments from our licensees through other channels such as seminars and correspondence. In addition, NBC also visited



banks, especially MFIs, in order to gain insights into their future business strategies, thereby helping NBC tailor appropriate supervisory plans. We also encourage banks and MFIs to visit NBC, to be forthcoming with information and updates from banks and MFIs as well as from NBC, and to demonstrate support and commitment to resolving regulatory concerns and compliance issues. To date, many issues raised by the private sector have been seriously taken into consideration by NBC, and several have been solved in favor of the ABC. (Appendix 03)

## 2.3 Anti-Money Laundering/Countering the Financing of Terrorism (AML/CFT)

### 2.3.1 Policy / Coordination Developments

The Kingdom of Cambodia is currently embarking on collaborative efforts with regional and international institutions to further strengthen its domestic defenses against money laundering and the financing of terrorism. These efforts are supported by international institutions, namely IMF, ADB, UNODC, APG, AUSTRAC, and the World Bank, in the convergence of global standards on the prevention of money laundering and terrorist financing.

### 2.3.2 Legislative Developments

As a full-fledged member of APG at the annual meeting in 2004 in Seoul, South Korea, Cambodia adopted the international standard contained in the 40 revised recommendations and 9 special recommendations of the Financial Action Task Forces procedures for effective evaluation of risks associated with money laundering and financing terrorism.

The National Bank of Cambodia, Banking Supervision department, with technical assistance for capacity building for banking and financial management, issued a *Prakas* (21/10/02) on *Standardized Procedures for Identification of Potential Money Laundering at the Banking and Financial Institutions* and a Circular (04/10/03) on *Suspicious Transactions and Know Your Customer Policies*. Moreover, to effectively prevent money laundering and combat the financing of terrorism, NBC, with IMF technical assistance, has already finalized the internationally standardized draft law on the *Prevention of Money Laundering and Financing of Terrorism*. This draft law has been submitted to the Council of Ministers for endorsement before the National Assembly reviews it for approval.

A Financial Intelligence Unit (FIU) is to be established under the control of NBC after the law on AML/CFT has been passed by the National Assembly. However, in the absence of AML/CFT legislations and in order to familiarize the staff with the new AML/CFT regime, a pre-FIU group has been established under the control of the Banking Supervision department of National Bank of Cambodia. The group is responsible for activities related to training, administration, and the drafting of laws and relevant regulations.

## 2.4 Challenges

### 2.4.1 Compliance with the Core Principles

Effective supervision of banking organizations is an essential component of a strong economic environment. The precondition for effective banking supervision includes sound and sustainable macroeconomic policies, a well-developed public infrastructure, an effective market discipline, procedures for the efficient resolution of irregularities in banks, and a mechanism for providing an appropriate level of systemic protection. As far as the supervisors are concerned, their task is to ensure that banks operate in a safe and sound environment and that they hold sufficient capital and reserves to support the risks that arise in their business.

There are certain infrastructure elements that are required to allow effective banking supervision. Where such elements do not exist, a supervisor should seek to put them in place. These elements are also known as the Basel Core Principles (BCP), which include preconditions for banking supervision, the licensing process, prudential regulation and requirements, methods of ongoing supervision, information requirements, remedial measures and exits, and cross-border banking supervision.

The IMF, on an informal basis, conducted an assessment of Cambodia's compliance with the BCP in September 2004. Results from the 25 Core Principle assessments demonstrate weaknesses in banking supervision in Cambodia, especially in prudential regulations and requirements. However, licensing and structure, methods of ongoing supervision, and remedial measures and exits were found to be broadly in line with the Core Principles. Cross-border banking assessment is not applicable in the Cambodian context as the banking system is not yet well developed.

The weaknesses in prudential regulations and requirements are basically related to credit policy, loan evaluation and provisioning, connected lending, risk management, internal control, and money



laundering. NBC must enhance internal control requirements, the first line of defense in a sound banking system.

NBC issued a regulation requiring banks to classify their loans into four categories: standard, substandard, doubtful, and loss. A certain level of provision is required against each category of classification. In practice, loan classification is based too extensively on payment experience, though the regulations also required financial conditions to be taken into consideration. The level of provision has been reduced to a level below the international standard. In addition, the regulatory provision is only a minimum requirement whereas most banks consider it sufficient even though expected losses may exceed the provisions. This is of particular concern in the Cambodian environment where property valuation and guarantee services are not very reliable.

Assessment of other risks, such as exchange rate risk, liquidity risk, operational risk, and interest rate risk, has not been done appropriately. This also reflects the fact that the internal control system of the banks cannot effectively cope with these risks.

Facing these weaknesses, the supervisory authority of Cambodia looks forward to establishing itself as a fully compliant supervisor. Prudential norms and the preconditions for effective banking supervision must be improved.

## **2.4.2 Implementation of International Financial Reporting Standard**

### ***IFRS 1: First-time adoption of IFRS's***

IFRS 1 applies to all entities adopting IFRS for the first time for accounting periods beginning on or after 1 January 2004. EU Regulations require listed European Union companies to apply IFRS's for periods beginning on or after 1 January 2005. This means that many EU companies will be first-time adopters for the year ending 31 December 2005.

### ***NBC's Requirements***

Banks (commercial banks, specialized banks, and microfinance institutions) are currently required to report in accordance with Cambodian Accounting Standards (CAS), which are less rigorous than IFRS.

In conjunction with the introduction of the new Chart of Accounts (COA) and the pending introduction of CAS, banks will be required to provide specific disclosures for financial statements, in addition to those required by the NBC. For the most part, bank audit reports based on International Accounting Standards (or IFRS's) and International Standards of Auditing comply with the disclosure requirements. NBC requires monthly and other periodic reports to be compiled by commercial banks and similar financial institutions.

A bank's financial statements must be prepared in accordance with CAS and NBC guidelines. In cases where current CAS rules do not stipulate the accounting treatment and/or disclosure requirement, recourse should be made to the IFRS. However, in the event the accounting requirements

imposed by NBC are different from CAS or IFRS, the requirements of NBC will prevail and take precedence over the CAS or IFRS.

### 2.4.3 Leasing Law

NBC is willing to develop financing possibilities for the private sector. It has participated in the process of drafting a new law allowing leasing companies to operate in Cambodia. Since leasing is considered a banking operation according to the *Banking Law*, the NBC has also drafted a series of *Prakas* allowing banks to lease and create a new category of financial institutions specialized in leasing. These leasing institutions could be allowed to operate soon without having to apply for a full bank license.

### 2.4.4 Other issues: Macro Economic Stability and Political Stability

Institutional stability plays a critical role in economic development. For instance, when economic growth ground to a halt in 1997, the domestic political crisis and the external financial crisis took their toll on Cambodia. In August 1997, bank deposits dropped by KHR 42 billion compared to December 1996 (i.e. a 4.4% decrease), whereas loans to customers increased by KHR 113 billions (i.e.; 3.2%). The recent political stability in Cambodia has promoted economic growth. For example, in December 2005, bank deposits increased by KHR 580 billion compared to December 2004 (18%), whereas loans to customers increased by KHR 603 billion (31%).

## 2.5 Capacity Building for Bank Supervision

Capacity building and development for the Banking Supervision staff through training needs additional attention in the coming year. NBC needs to be effective in evaluating a bank's soundness and compliance with banking laws and regulations and the quality of its management and directors, and in identifying the areas where prompt corrective action is required to strengthen the bank. These actions are in line with a conscious effort on the part of NBC to continuously improve the skills of bank supervisors in order to cope with an increasingly dynamic banking market.

In this regard, the Banking Supervision department has obtained technical assistance from various organizations, including International Monetary Fund (IMF), Asian Development Bank (ADB), Deutsche Bundesbank, and AUSTRAC. In addition, training on banking law and regulations and other issues involved with supervision has been delivered every Monday morning since early 2005, with 34 bank supervision staff in attendance at each meeting.

Besides local training, NBC staff participated in overseas courses under a cooperation program with various central banks and organizations including Deutsche Bundesbank, Bank of Vietnam, Bank of China, SEACEN, AUSTRAC, and IMF. As a result, 48 staff and officers were nominated to attend. For example, a number of supervisors joined the seminars on **Basel II** and International Rating-Basel System, On-Site Bank Supervision, Combating Money Laundering and other valuable courses. Moreover, post-graduate courses have been provided by IMF, JICA, and AUSAID. However, in terms of Information Technology, the knowledge of Banking Supervision staff is still below par. It is very important for the Bank's supervision staff to be informed on information technology in the present and

future Cambodian banking environment. In general, significant steps have been taken to maximize the benefits of the training programs.

## 2.6 Major Regulatory Actions

Regulations relating to the implementation of Law on Banking and Financial Institutions:

- 1- *Prakas* on the Licensing of Banks
- 2- *Prakas* on the Licensing of Rural Credit Specialized banks
- 3- *Prakas* on the Licensing of Microfinance Institutions
- 4- *Prakas* Relating to Liquidity for Banks and Microfinance Institutions
  - First amendment of *Prakas* on No B7.02-187
  - Second amendment of *Prakas* No B7.04-207
- 5- *Prakas* on a Banks' Minimum Capital
- 6- *Prakas* Relating to the Banks' Solvency Ratio
  - Amendment of *Prakas* No B7.04-206
- 7- *Prakas* on the Calculation of Banks' Net Worth
- 8- *Prakas* on the Accounting Process for Foreign Currency Transaction
- 9- *Prakas* on the Classification and Provisioning for Bad and Doubtful Debts Including Interest in Suspense
  - Amendment of *Prakas* No B7.02-145
- 10- *Prakas* on Controlling Banks' Large Exposures
- 11- *Prakas* on a Bank's Capital Guarantee
- 12- *Prakas* on Loans to Related Parties
  - Amendment of *Prakas* No B7.02-146
- 13- *Prakas* on the Establishment of the Inter Bank Market Working Group
- 14- *Prakas* on Fixed Assets of Banks
- 15- *Prakas* on Transfer of Shares of Banks
- 16- *Prakas* on Standardized Procedure for Prompt Corrective Action for Banking and Financial Institutions
  - Amendment of *Prakas* No B7.05-2121
- 17- *Prakas* on Standardized Procedure for Identification of Money laundering at Banking and Financial Institutions
- 18- *Prakas* on Adoption and Implementation of Chart of Accounts for Banking and Financial Institutions
- 19- *Prakas* on Broker Dealer Operation of a Bank Licensed in Cambodia
- 20- *Prakas* on Payments of Dividends in Advance
- 21- *Prakas* on Prepaid Prepayments on Rental and Leases
- 22- *Prakas* on Requirement in Compliance with Fact and Substance
- 23- *Prakas* on Publication of Annual Audit of Financial Statements of Banks and Financial Institutions
- 24- *Prakas* on License Fees for Banks and Financial Institutions
- 25- *Prakas* on Loan Policies Procedures and Lending Authority
- 26- *Prakas* on the Calculation of Interest Rate on Microfinance Loans
- 27- *Prakas* on Loan Classification and Provisioning Applicable to Microfinance Institutions.

- 28- *Prakas* on the Maintenance of Reserve Requirement for Microfinance Institutions
- 29- *Prakas* on Reporting Requirement for Registered NGOs and licensing Microfinance Institutions.
- 30- *Prakas* on Liquidity Ratio applicable to licensed Micro finance Institutions
- 31- *Prakas* on Registration and Licensing of Microfinance Institutions
- 32- *Prakas* on Adoption and Implementation of Chart of Accounts for Microfinance Institutions
- 33- Circular on the Communication and Copies of Documents during On-site inspection
- 34- Circular on Daily Accruals and Amortization for Commercial and Specialized Banks
- 35- Circular on Suspicious Transactions and "Know Your Customer" policies
- 36- Circular on Non-Performing Loans Provision an interest account
- 37- Circular on Installment Loans Classification and Provision
- 38- Circular on Requirement for Banking and Finance Institutions to have a System of Checks and Balances
- 39- Circular on Multi-currency Accounting following Implementation of Uniform Chart of Accounts
- 40- Circular on the Selection of Independent Auditors by Banks and Financial Institutions
- 41- Law on Negotiable Instruments and Payment Transactions Adopted by National Assembly on September 19, 2005

## 2.7 Outlook for Banking Supervision department in 2006

All divisions of Banking Supervision have action plans and strategies to improve in the coming year. All divisions will implement the project by concentrating on the issues that each unit has set up. The department is responsible for co-ordinating with the United Nations Development Program to organize a summit on Cambodian Microfinance which will take place on the 11-13 January 2006 and will be attended by the prime minister.

The Off-Site Supervision division plans to continue developing an information system to strengthen the off-site supervisions system. This new system enables Off-Site supervisors to manage bank information in digital form, and to generate financial data automatically in order to improve task performance. The Bank Performance Report (BPR) was designed and set up for consolidating original data from the Bank General Ledger of individual banks. This Bank Performance Report will generate the Cambodia Off-Site Bank Reporting for Prompt Corrective Action (COBRA).

The On-Site Examination division has set strategies for conducting full-scope on-site examinations in the coming year for commercial banks and specialized banks. The examination will be conducted when additional information is required by the Off-Site division or if any discrepancies need verification. The findings will report any forms of non-compliance with the prudential regulations of the National Bank of Cambodia. Any concerns found by the team will be



reported to the examined banks for prompt corrective actions and will be issued within a specific period by the Banking Supervision department.

The Microfinance division has set a yearly plan for the Off-Site Examination section and the On-Site Examination section to conduct work on microfinance institutions in order to improve the performance of microfinance institutions operating in the rural areas. The division continues to encourage rural credit operation, which is a crucial factor in rural development and poverty alleviation. The division works to strengthen microfinance operations by motivating NGOs, microfinance institutions and rural credit operators to apply for licenses and to register with NBC. To improve and strengthen supervisory activity, the division continues on-the-job training of On-Site and Off-Site supervision staff.



For 2006 the division will conduct on-site inspections of licensed microfinance institutions and NGOs which have applied for licenses or registration as rural credit operators in order to follow up on the progress of rural credit businesses. The division will investigate and encourage any NGOs and informal moneylenders who offer credit services to register with the National Bank of Cambodia.

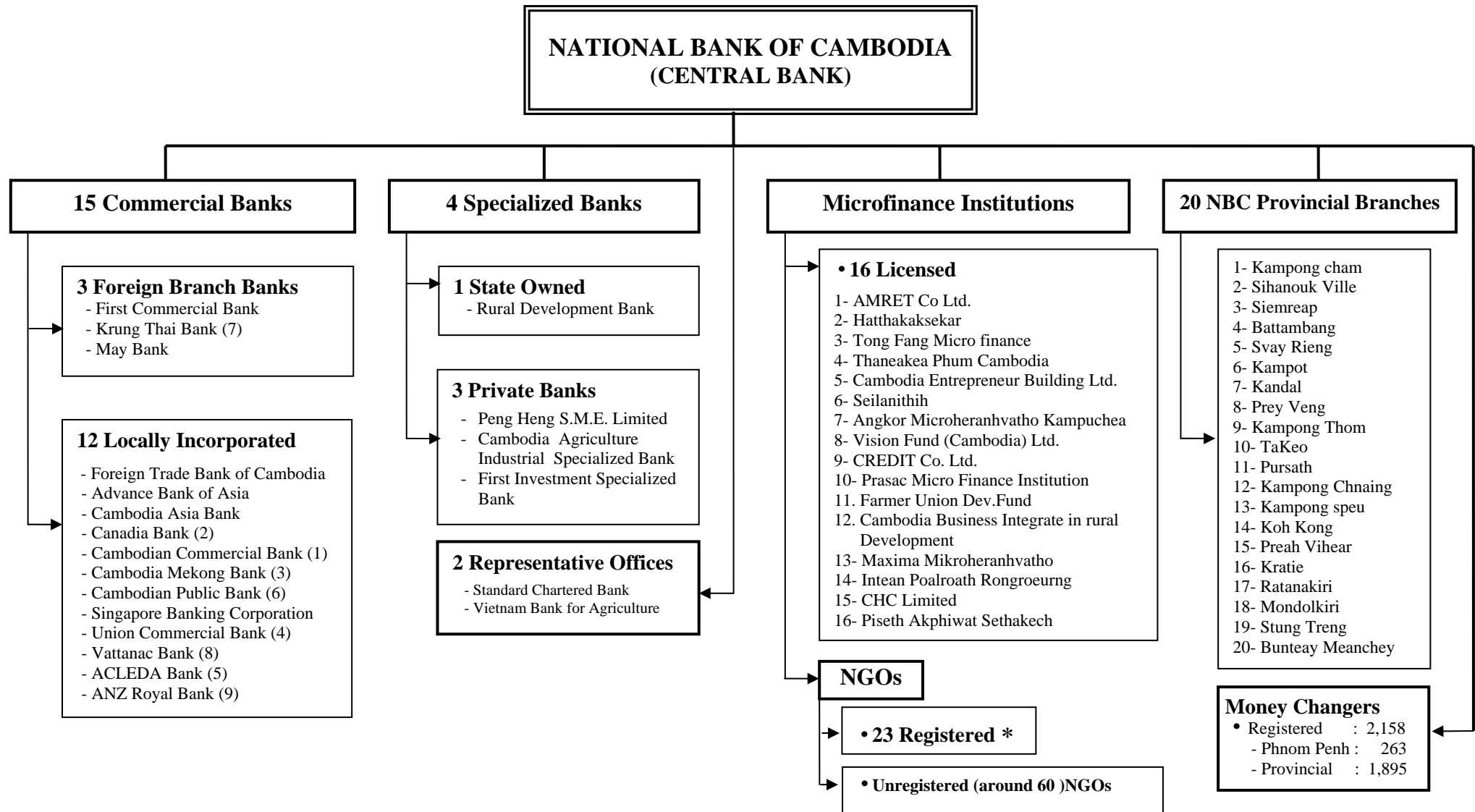
The Administration, Regulation and Licensing division is planning for the coming year to prepare and review prudential regulations so as to be consistent with the real situation. NBC intends to disclose an updated version of all regulations on its website in the near future. The Administration, Regulation, and Licensing division also monitors that all banks reports are submitted in a timely fashion to the department.



Officers of the Banking Supervision Department



**Organized chart of banking system in Cambodia**  
**THE BANKING SYSTEM IN CAMBODIA**



License is to be renewed every 3 years.

• Officially opened

\* See next page

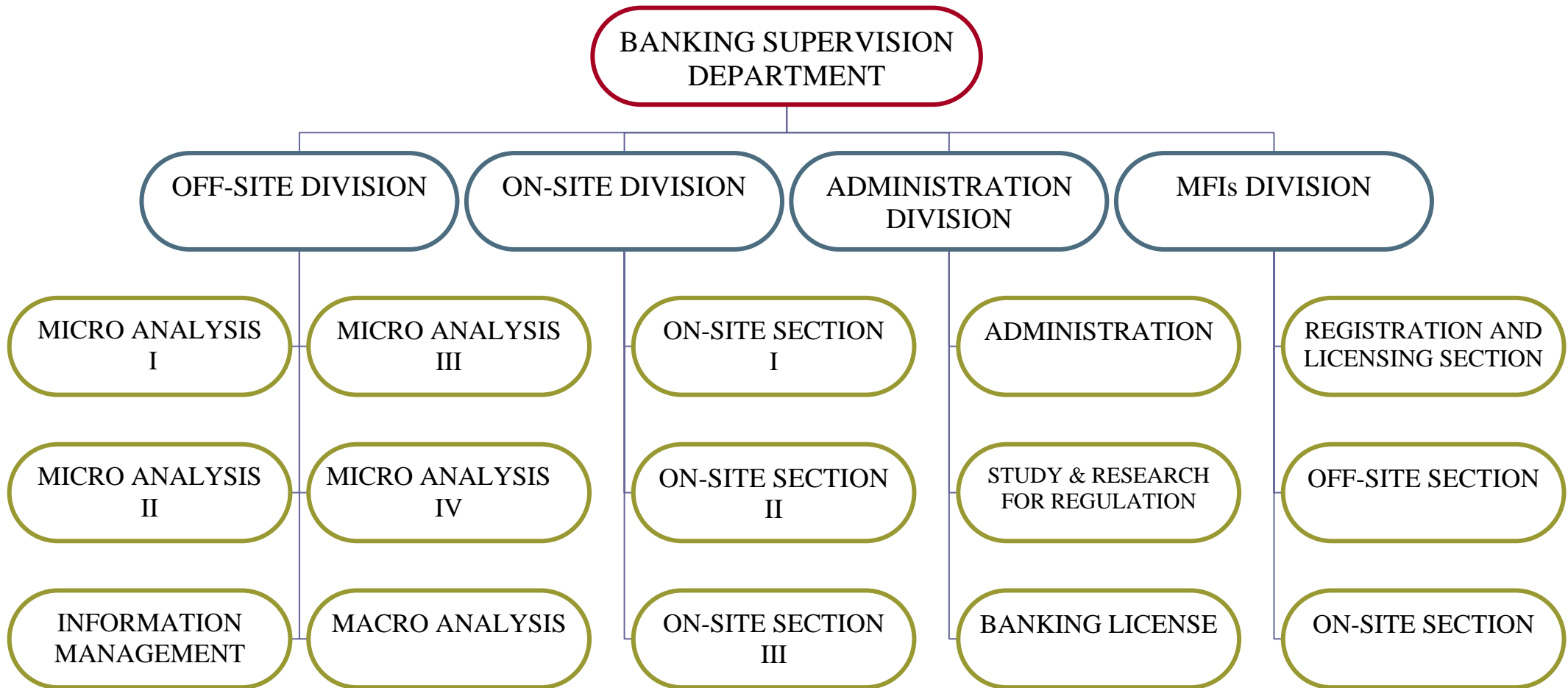
## \* 23 NGOs registered

<ul style="list-style-type: none"> <li>1- Agriculture &amp; Tourism Development Association</li> <li>2- Aid Farmers Association</li> <li>3- Association for Business Initiative</li> <li>4- Association for Development of Diversified Khmer Nation</li> <li>5- Buddhism for Development</li> <li>6- Cambodia Community Saving Federal</li> <li>7- Cambodia Credit to Abolish Poverty Organization</li> <li>8- Cambodia Rural Economic Development Organization</li> <li>9- Cambodia Women's Development Agency</li> <li>10- CICM Cambodia</li> <li>11- Crop Supporting National Association</li> <li>12- Islamic Local Development</li> <li>13- Khmer Rural Development Association</li> <li>14- Kratie Women Welfare Association</li> </ul>	<ul style="list-style-type: none"> <li>15- Lutheran World Federation Organization</li> <li>16- Ministry of Rural Development Credit Scheme</li> <li>17- Northwest Development Association</li> <li>18- Rural Development Association</li> <li>19- Rural Economic Development</li> <li>20- Rural Family Development</li> <li>21- Social Development in Rural</li> <li>22- Ta Ong Soybean Development Association</li> <li>23- Women's Savings and Development Cooperation</li> </ul>
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BANK BRANCHES	No	CLOSED BANKS	Dated of withdrawal
(1) Battambang, Siemreap, (Sihanoukville closed 22-Jan-01)	2	1-Credit Bank of Cambodia license withdrawn	06-May-95
(2) Sihanoukville, Olympic, Battambang, Kampong cham, Pailin, Charle Degaule, Siemreap, Poipet, Kampot, shopping center sorya, Banteay Meanchey	11	2-Cambodia development Bank (Voluntarily liquidated)	24-Jun-96
(3) Regency square, Siemreap, Sihanoukville, Daun Penh,	4	3-Royal Cambodia Bank (Voluntarily liquidated)	1996
(4) Sihanouk ville, Siemreap, Battambang	3	4-Municipal Bank (Closed)	04-Apr-98
(5) ACLEDA Bank: Provincial branches	18	5-Siam City Bank P.Penh branch (ceased operation)	01-Nov-98
(6) Siemreap, Sihanoukvill, Battambang	3	6-P.T.Lippo Bank P.Penh branch (ceased operation)	25-Jun-99
(7) Siemreap (Sub-Branch)	1	7-Chansavangwonk Bank Corporation (Voluntarily liquidated)	31-Jul-00
(8) Siemreap	1	8-Cambodia Bank International (Voluntarily liquidated)	31-Jul-00
(9) Independence Monument, Riverside, Olympic Market, Kramoun Sar	4	9-Cambodia Farmers Bank (Compulsory liquidation)	31-Jul-00
<b>Total</b>	<b>47</b>	10-Angkor Bank (Voluntarily liquidated)	31-Jul-00
		11-Global Commercial Bank (Voluntarily liquidated)	08-Dec-00
		12-Great International Bank Ltd. (Voluntarily liquidated)	08-Dec-00
		13-Pacific Commercial Bank Ltd. (Voluntarily liquidated)	08-Dec-00
		14-Phnom Penh City Bank (Voluntarily liquidated)	08-Dec-00
		15-Bangkok Bank Public Co.Ltd.P.P branch (Voluntarily liquidated)	08-Dec-00
		16-Rich Nation Bank (Compulsory liquidation)	08-Dec-00
		17-Agriculture-Commercial bank (Compulsory liquidation)	08-Dec-00
		18-Thai Farmers B.Public Co.Ltd.P.P branch (Voluntarily liquidated)	30-Mar-01
		19-First Oversea Bank (Compulsory liquidation)	19-Mar-02
		20-Singapore Commercial Bank (Voluntarily liquidated)	19-Mar-02
		21-Emperor International Bank (Voluntarily liquidated)	04-Apr-02
		22-Standard Chartered Bank downgrade to representative Office	01-May-02
		23-Credit Agricole Indosuez Bank (Voluntarily liquidated)	18-Sep-02

### Banking Supervision Department Organization Chart



### Services including Banking & Finance Working Group Proposed WG Agenda 2005

N°	Issues	Recommendations	Progress	Current Status	Implementation
1	<b>Expiry Date on Licenses – 3-year license renewal process review recommendation</b>				
	Upon application and approval from the NBC, banks are provided with licenses for three-year periods. This has caused considerable confusion and difficulty for all commercial banks in dealing with overseas banking and regulatory organizations. The current regime is not in accord with international custom and is widely misunderstood.	The commercial banks requested that NBC should not impose expiry dates on banking licenses.	NBC responded that on the issue of licenses the current system would be kept until 2006-07. The NBC will reconsider the request. (B&F WG meeting August 17 <sup>th</sup> 2004)	NBC still issues 3-year licenses to banks and is seriously studying the possibility of issuing permanent licenses to banks and financial institutions which are in full compliance with the law and prudential regulations of the NBC	
2	<b>Branch Licenses</b>				
	The private sector discussed the issue of issuing two licenses to offer increased opportunity for banks to increase branch operations in the provinces: 1) A restricted branch license and 2) A full branch license	It was recommended that in 2005 NBC consider providing two types of licenses, i.e., 1) Full and 2) Restricted. The banks need to make a distinction between limited operations available in the provinces, such as deposit taking, and the full operation of the head offices. This is the reason why the issue of full branches and sub-branches is important.	NBC stated that they will issue a guideline <i>Prakas</i> on this matter and will distribute to the PS for discussion. The <i>Prakas</i> will define the operations to be considered by branches, sub branches and agents. This <i>Prakas</i> will be forwarded to the PS for review and to seek consent.	The <i>Prakas</i> guideline will be finished after receiving comments from the Banking & Finance Working Group.	

<b>3</b>	<b>Draft Anti-Money Laundering Law</b>			
	Reviewing draft of Law on Anti Money Laundering.	The PS requests that NBC take into account the impact of the law on Cambodia.	In reference to the AML, NBC reported that assistance had been received from the IMF, France, Australia, Germany and Japan. The RGC has formed a Working Group that includes NBC, MEF, MoJ and MoI to work on this law to ensure that it complies with the situation in Cambodia. NBC has organized two dissemination seminars relating to the AML for the PS. (8 <sup>th</sup> GPSF, March 2005)	The PM had concerns regarding the implementation of the AML. The PM observed that AML is an international issue. The RGC cannot avoid enacting this law. The PM responded to the PS that their concern in reference to the AML will be addressed as the RGC needs to adopt the AML (8 <sup>th</sup> GPSF, March 2005)
	PS believe that the difficulty of AML is due to law enforcement and the legal infrastructure not being available to fully service the AML.	PS recommend more consultation with the NBC to properly implement the AML	NBC will submit the draft to the Banking Association before forwarding to the Council of Ministers.	
	The banks cannot keep records for ten years because of volume of records and the physical deterioration of paper, ink and CDs.		NBC requires commercial banks to report on transactions over 10,000 and make a record and report when suspicious transactions take place. (B&F WG meeting November 2005)	
<b>4</b>	<b>Law on Secured Transactions</b>			

5	<b>Treasury Bills (TB) &amp; Bonds</b>				
	Cambodia is a new market for bonds & treasury bills. If the market is required to move to TB and bonds, incentives are required. If there are no incentives then the confidence will not pass to the market and the investor.	The PS recommends that NBC allow the banks to use treasury bills and bonds as a portion of the reserve requirement on demand deposit.	In reference to treasury bills and bonds, the PM decided that an in depth study is required on this issue. The PM insisted that financial institutions and the MEF conduct an in-depth study on this issue. The PM suggested that the minimum capital requirement should be replaced with treasury bills and bonds at some level. (8 <sup>th</sup> GPSF, March 2005)	The PM agreed to the NBC response that: reserve requirement and treasury bill are two instruments that are of different natures and have purposes. While reserve requirement is mainly in US dollars and fluctuates according to the volume of customers deposit in the banking system, treasury bills are denominated in riel. The two cannot substitute for each other.	NBC will keep the current system of reserve requirement as in the <i>Prakas</i>
6	<b>Solvency Ratio</b>				
	In response to a private sector request relating to a request that banks be rated by S&P so that they do not face 100% risk, NBC issued a <i>Prakas</i> on the S&P rating.	The <i>Prakas</i> does not elaborate on overseas banks. The PS recommends that reference to overseas banks be added to the <i>Prakas</i> .			
7	<b>Credit Information Sharing System</b>				
	Although the PS fully supports the Credit Information Bureau, a concern relates to the input of the data. The input of data is important for the success of the Credit Bureau and so a guideline on the input of data	The private sector recommended that guidelines on this be prepared.	NBC responded that this issue will be discussed with the ADB and that something will be prepared. The NBC reported that there is a draft plan to organize a seminar with Commercial Banks for the	The draft Code of Conduct has been circulated amongst member banks. NBC is waiting for comments and feedback from member banks.	

	is required. How will data be viable (secure)? How will the members use it?		next month (B&F WG meeting, November 18, 2004)		
	Concerns relating to the rules of disclosure under the Articles of the Finance Law.	The private sector recommended that a guideline or <i>Prakas</i> on confidentiality of secrecy be issued by the NBC as the Banking Law partially covers this issue and that it is better to have the banks protected.	NBC responded that the Articles in the Finance Law are to prevent staff, auditors or inspectors disclosing information without NBC's permission to protect the banks. (B&F WG meeting, November 18, 2004)		
	The PS supports the idea for legislation to create a central organization for sharing credit information among banks. (7 <sup>th</sup> GPSF, March 2005)	The PS also believe this requires careful study in order to ensure that the interests of all concerned, banks and customers alike, are taken into consideration. (8 <sup>th</sup> GPSF, March 2005)			
<b>8</b>	<b>Issue of Nature and Practice of Prudential Inspection</b>				
	As the prudential inspectors seek greater detail there is concern over the commercial nature of these requests.	The private sector recommends that the inspectors make their requests for this information formally in black and white. Why does NBC seek so much detail?			NBC is the supervisory authority and is responsible for making sure that banks observe the rules and regulations. Without a comprehensive look at such documents, a constructive judgment cannot be made. NBC supervisors are bound by law to maintain confidentiality.