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*The NGO Forum on Cambodia*



**FAIR FINANCE CAMBODIA**

A MEMBER OF FAIR FINANCE ASIA

# Environmental and Social Impact Assessment (ESIA) Compliance in Cambodian Finance and Banking



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## List of Abbreviations

<b>Ibid.</b>	in the same place
<b>ABC</b>	The Association of Banks in Cambodia
<b>ADB</b>	Asian Development Bank
<b>CBC</b>	Credit Bureau Cambodia
<b>CITES</b>	Convention on International Trade in Endangered Species of Wild Fauna and Flora
<b>CSFI</b>	Cambodian Sustainable Finance Initiative
<b>CSR</b>	Corporate Social Responsibility
<b>EHS</b>	Environment, Health and Safety
<b>ESIA</b>	Environmental and Social Impact Assessment
<b>ESMS</b>	Environmental and Social Management System
<b>ESS</b>	Environmental and Social Standard
<b>FDI</b>	Foreign Direct Investment
<b>IFC</b>	International Finance Corporation
<b>MoU</b>	Memorandum of Understanding
<b>MoE</b>	Ministry of Environment
<b>NBC</b>	National Bank of Cambodia
<b>PS</b>	Performance Standard
<b>SPS</b>	Safeguard Policy Statement
<b>USD</b>	United States Dollar
<b>WB</b>	World Bank

## Executive Summary

### **Introduction:**

Banking and financial institutions are essential sources of capital for investments in developmental projects. Although financing these projects is economically beneficial, their potential environmental and social consequences require serious contemplation. Institutions that lend to development projects are indirectly responsible for the damages to resources from the project's activities. Customarily, banks' scrutiny of borrowers is limited to financial evaluation to determine loan-repayment capabilities without considering potential environmental impacts. This lack of ecological and social accountability severely affects resources and may cause the project's failure, ultimately leading to loan defaults.

### **Study objectives:**

- This study aims to understand the challenges and best practices of banks in encouraging their clients to implement **Environmental and Social Impact Assessment (ESIA)** (*Sub-Decree No. 72*) requirements to perform Environmental and Social Governance (ESG) responsibly and sustainably, and policy gaps in the banking and environmental sectors which promote good ESG practices. The report also proposes policy and implementation options for the Ministry of Environment and the banking sector to ensure good governance with sustainability principles in mind.
- The study also aims to compile a case study on the best practices of a selected bank and its clients' performance in improving ESG in Cambodia, especially in the fields of agribusiness and hydropower; and to disseminate and present to stakeholders, including the **Ministry of Environment (MoE)**, the **National Bank of Cambodia (NBC)**, the **Association of Banks in Cambodia (ABC)**, recommendations for policies to promote consistent and accountable investment in the financial sector.

### **Study methodologies:**

This study uses a qualitative approach to collect information and data to analyse and understand the research aim. Data collection included:

- key informant interviews (with representatives from the NBC, ABC and MoE)
- documentation of case studies on best practices of banks
- consultative workshop with other key relevant stakeholders.

### **Study results and discussions:**

For the environmental sector, there are key legislations such as:

- *The 1996 Law on Natural Resources Management and Environmental Protection*
- *The 1999 Sub-Decree no. 72 on Environmental Impact Assessment Process*
- *The 2009 Prakas no. 376 on General Guideline for Preparing the Initial Environmental Impact Assessment*
- *The 2020 Prakas no. 021 on Classification of Development Projects for Environmental Impact Assessment.*

Currently, there is no legal provision for the inclusion or integration of ESIA in Cambodia's banking and financial institutions' policies and practices, a shortcoming that highlights the need to begin

acknowledging the potential social and ecological consequences from funding development projects.

On the other hand, there are some crucial legislations for the finance and banking sector too, such as:

- *Law on Financial Lease (2009)*
- *Law on Anti-Money Laundering and Terrorism Financing (2020)*
- *Law on Commercial Enterprises (2005)*
- *Law on Negotiable Instruments and Payment Transactions (2005)*
- *Law on Foreign Exchange (1997)*
- *Law on Organization and Functioning of the National Bank of Cambodia (1996)*
- *Law on Amendment of Articles 14 and 57 of the Law on Organization and Functioning of the National Bank of Cambodia (2006)*
- *Law on Banking and Financial Institutions (1999).*

No legal basis or provision institutionalizes environmental and social protection from Cambodia's financial and banking operations, except the **Code of Banking Practice (2015)**, which guides the ABC to emphasize the criteria based on the Sustainable Finance Principles in approving credit to clients. Clause 12.1 of the code recommends that banks diligently assess customers' credit repayment ability, using five prescribed criteria. However, the code and the pre-lending assessment criteria do not consider environmental and social issues that may affect clients' businesses and, ultimately, their ability to repay loans.

The practice so far has been for project owners or clients receiving loans or credit from international banks such as the **Asian Development Bank (ADB)**, **World Bank (WB)**, or the **International Finance Corporation (IFC)** to diligently study and prepare ESIA's to meet the rightful conditions of those banks. These conditions reflect the recognition of concerns about environmental-social issues and long-term sustainable development, which are currently actively discussed topics in the context of development. The provision of loans or credit in any amount enables clients or project owners to develop several large-scale projects that could pose significant risks and impact the environmental and social resources of the local communities. Financing provides clients with sufficient capacity to clear, build, utilise resources, and operate their projects on a large scale, potentially leading to disruptions or conflicts with resources and livelihood activities of people in and around the project areas.

Financial and banking institutions in Cambodia have not exercised the requirements of ESIA in providing loans. Some of the challenges for doing so include low motivation, high market competition, and limited awareness among banking and financial operators and the public of environmental and social protection benefits. Immediately fulfilling such obligations may be an additional constraint or complication for both operators and clients seeking loans from banking and financial institutions.

Moreover, the study results and consultation with stakeholders at a November 4, 2020 meeting confirm that Cambodia's finance and banking sector has not yet implemented ESIA obligations as conditions for approving loans. The best practice of this assessment process in the finance and banking sector was not available during this study period, as the MoE and the NBC are yet to identify a legal requirement for the current banking and financial institutions doing businesses in

Cambodia.

In the volatile context, bank financing has boosted the momentum of industrialization, urbanization, agriculture, and tourism through related development projects. Those momenta have led to changes in land use and human settlements, resulting in declining water and land quality, degradation and loss of biodiversity, encroachment on forests, increased pollution, and negative impacts on human health. Banking institutions in Cambodia must begin to understand the adverse environmental and social consequences of loans or credit to reduce potential risks to their clients and development projects.

**Conclusion:** Cambodian banking and financial institutions have not implemented ESIA as pre-conditions to approve potentially risky loans. In contrast, several international banks (such as the ADB, WB, and IFC) have developed strong safeguard policies on the environment, forests, resettlement, indigenous peoples, cultural legacies, and regions in conflict as preconditions for approving loans. The lack of enforcement of similar safeguards in the Cambodian banking and financial sector is particularly concerning. Credit from this sector has contributed extensively to many development projects that have damaged resources or led to conflicts with local populations. The study results presented in this report demonstrate the disconnect between the financial sector and the implementation of environmental policies, even though some institutions have begun to integrate awareness and obligations towards ecological and social responsibilities. In response to these shortcomings, the report identifies several solutions and measures needed to promote the joint implementation of ESIA for loans or credit with potential ecological and socio-cultural risks.

**Key recommendations:**

The MoE and the Department of Environmental Impact Assessment should initiate or continue discussions with the NBC and the ABC to find policy-forming solutions to promote the implementation of environmental and social requirements for funding development projects, as enumerated in the appendix list of *Declaration no. 021 PRK.BST dated 03 February 2020 on The Classification of Environmental Impact Assessment for Development Projects*. Based on the 2019 MoU, the common policy includes the joint declaration on ESIA report requirements for the banking sector in Cambodia.

As an entry point and to ease the work, the NBC should introduce a guiding policy (set as a requirement) for financial and banking institutions to apply or consider the ESIA policies and regulations (particularly *Sub-Decree no. 72, Declaration no. 021, 092, 116, 118, 119, 120 and 376*) before their loan or credit approvals. In addition, the compliance report to these policies and regulations should be regularly submitted to the NBC for archiving, reference, and future monitoring of their performance.

With financial and technical assistance from its partners and the Department of Environmental Impact Assessment as its general staff, the MoE should develop additional guidelines on required procedures and operational standards for ESIA that Cambodian banks can implement. This procedure and standard can include a joint declaration (between the MOE and the NBC) on:

- ESIA requirements in the banking sector
- a handbook on legal standards regarding ESIA
- procedures for monitoring and approving the ESIA report
- the process of public participation in the ESIA study



- the environmental observation
- some administrative formalities (like Rapid Assessment Metric for classifying environmentally risky loan projects), which can facilitate banks to implement ESIA requirements on consumer loans.

For long-term environmental and social protection, the MOE and the NBC should necessitate lending banks to establish an *Environmental and Social Management System (ESMS)* to ensure the reduction of ecological or social damages and adequate compensation when such damage occurs. The MOE and NBC can guide lenders in establishing the ESMS through policies and implementation tools like relevant technical guidelines.

Banking and financial institutions need to continue strengthening and operating more thoroughly before approving loans, emphasizing the procedures for evaluating and controlling loans and monitoring loan operations later. Suppose borrowers use the loan for purposes other than those stated in the contract, for businesses prohibited by state laws, or activities with harmful social and environmental consequences. In that case, banks must immediately withdraw the loan. Borrowers must be required to conduct ESIA or fulfil their legal obligations before the loan is renewed. In severe cases, the loan must be terminated unconditionally.



# Environmental and Social Impact Assessment (ESIA) Compliance in Cambodian Finance and Banking

## 1. Introduction

The finance and banking sector has played an essential role in and is one of the mechanisms for promoting sustainable economic growth. Ensuring cash flow and currency circulation is a primary task in increasing economic activity for the nation and the people earning a living. The proliferation of many banking and financial institutions in Cambodia is a clear testament to the growth of economic activity, including a rise in investment or development projects proposed to comply with the Development Policy of the Royal Government of Cambodia. These banking and financial institutions are a source of essential capital for investments. While financing development projects are economically beneficial, these projects' ecological and social impacts need serious scrutiny.

According to local and international media reports, several major development projects' environmental and social effects have provoked hostilities with the local population. These impacts can be indirectly attributed to the financial institutions funding the projects. Customarily, before approving a loan, banks scrutinise borrowers' financial status to evaluate their loan-repayment capacity without regard to the potential environmental impacts of the proposed project. This lack of ecological and social accountability leads to the damage of resources and, ultimately, the failure of the project itself, resulting in the inability to repay debts.

To protect the future of Cambodia, the **Association of Banks in Cambodia (ABC)** set a sustainable fiscal policy in March 2019. This policy demonstrates a solid commitment to prioritizing the protection of the environment, communities, and cultural heritage through environmental impact assessment and management and mitigation of risks or adverse effects that may result from customers' activities, standards, and practices. It is also a specific model and starting point for protecting natural and social resources from development projects associated with a high degree of risk.

As the Environmental Code has not yet been adopted, the requirements for the Environmental Impact Assessment function fall under **Sub-Decree No. 72 on Environmental Impact Assessment Process (1999)** and **Declaration No. 376 on General Guideline for Developing Initial and Full Environmental Impact Assessment Reports (2009)** of the MoE. Consideration of environmental protection and the need for ESIA in the banking and financial sector are topics that should be necessarily discussed and addressed to reduce these risks from development or investment projects financed by Cambodian banking and financial institutions.

**Fair Finance Cambodia (FFC)**, initiated and led by **Oxfam**, has the **NGO Forum on Cambodia, Cooperation Committee for Cambodia (CCC), Action Aid International Cambodia, Transparency International (TI)**, and **SILAKA** as members. These groups will work together to implement

strategies for protecting environmental-social resources and economic sustainability. To achieve this, they will conduct a study compiling banks' challenges and interests in applying the rules and regulations of the MoE (such as Sub-Decree 72). The study will also provide information to stakeholders such as corporations, civil society organizations and NGOs on policy options and operational standards for environmental impact assessments in Cambodia's banking and financial sector.

## 2. Study Objectives:

The main objectives of this study are:

- To study and understand the challenges and best practices of the banks in promoting the application of the requirements of Environmental Impact Assessment (Sub-Decree No. 72) to its clients to be responsible for performing environmental-social governance in a sustainable manner
- To study and understand the policy gaps in the banking and environmental sectors which promote good environmental and social governance
- Propose some policy and implementation options for the MoE and the banking sector to ensure good governance in a sustainable manner
- To compile a case study on the best practices of a selected bank and its clients' performance in improving environmental and social governance in Cambodia, especially in the fields of agribusiness and hydropower
- To disseminate and present to stakeholders, including the MoE, the National Bank of Cambodia, the Banking Association of Cambodia, recommendations for policies that promote consistent and accountable investment in the financial sector.

### 3. Research Methodology:

This study uses a qualitative approach for collecting information and data to analyse and understand the research aim. The study utilised the following methods:

#### 3.1 Collection of primary data and information:

- A. Interviews with Key Informants:** The researchers requested separate interviews with key informants who could discuss, share, and exchange ideas and experiences relevant to formulating policy on the banking sector, primarily related to social responsibility and environmental protection obligations, or environmental impact assessment requirements for contracts or loans with banks. The interviewed organizations or units include:
- **The Department of Environmental Impact Assessment of the Ministry of Environment:** To ascertain the current legal framework and implementation of the environmental impact assessment process. Also, to evaluate the feasibility of making environmental impact assessments conditional for lending to large-scale development projects.
  - **The National Bank of Cambodia (NBC):** To understand the goals and working approaches set by NBC, the top governing body for banking systems and operations in Cambodia, to protect environmental and social resources and ensure there is no exploitation or destruction of the socio-environmental resources in the finance and banking sector. The interviews with key informants from this organization helped shed light on awareness of policy, legal shortcomings, and challenges in the Bank's operations, which could pose a risk to the social and ecological resources exploited by the investment or development projects funded by banks. The author conducted a face-to-face interview with the Deputy Director-General of Banking Supervision and the Director of the Supervision Department II of the NBC on October 16, 2020.
  - **The Association of Banks in Cambodia (ABC):** To find ways to increase awareness of the ESIA requirements and environmental and social responsibility amongst members, staff, and clients who are lenders and discuss the starting point for integrating ecological protection in the Bank's operations and loan processes.
- B. Preparation of a case study on the bank's best practices:** This case study demonstrates the bank's commitment and approach to recognising the impact of banking and financial operations and engaging clients or lenders to reduce and manage risks to the environment and community.
- C. Organizing consultative workshops with various stakeholders:** The representatives from the MoE, the NBC, the ABC, WB, ADB, Ministry of Economy and Finance, Cambodia Chamber of Commerce, Preah Leab National Agricultural Institute, Cambodia Institute of Technology, Royal Academy of Cambodia, Royal Agricultural University, Royal University of Phnom Penh, and civil society organizations were invited to participate in the dissemination, sharing of results, and collection of additional input and feedback on this study report on 04 November 2020 at The Cambodiana Hotel.
- D.** Researchers analysed the collected data and information to prepare reports focusing primarily on key findings and recommendations to promote better accountability for banks and business operations with clients or lenders and integrate environmental

protection and resource governance standards into policies, legal frameworks, and their practical implementation

### 3.2 Collection of Secondary Data and Information:

To collect secondary data or information, the researchers examined the existing documents, reports, or intellectual resources about policies, legal frameworks, and practices about environmental impact assessment, banking and financial sector, environmental-social responsibility, and other experiences. The literature review compiled research documents from former and current studies or project results implemented in Cambodia. These sources of information, data, and documents are available at libraries, universities, government institutions, non-governmental organizations, and other related entities. In addition, the researchers searched for records from websites of major banking institutions, such as the NBC, the ABC, and some private banks. The researchers also used other documents such as books, scientific research articles, theses, and other reports related to this study's subject to consolidate this report.

### 3.3 Limitations of the Study:

- The author could not interview the Association of Banks in Cambodia since their schedule was tight during the study.<sup>1</sup>
- The author could not interview officials from the Department of Environmental Impact Assessment because the MoE did not respond to the requesting letter for the interview.
- For the consultative workshop on 04 November 2020, key stakeholders were invited one week before the meeting date, but there were no representatives from the MoE and ABC in the workshop.<sup>2</sup>
- After the consultative workshop on 04 December 2020, a final draft of the study report was sent to ABC and MoE for final feedback and comment. However, there was no response.<sup>3</sup>
- The best practices of ESIA's in the Cambodian financial sector could not be documented because these assessments are either absent or deficient. Most entities exercise Corporate Social Responsibility (CSR) instead.
- For the subsequent study, the interested researchers shall focus on what financial and banking institutions can do to start institutionalizing environmental concerns in their operations.

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<sup>1</sup> This is referred to the ABC's letter no. 126/20 sor.thor.kor date on 07 October 2020 in responding to the requesting letter from the NGO Forum on Cambodia for the interview appointment, dated 30th September 2020

<sup>2</sup> Letters from The NGO Forum on Cambodia dated on 26 October 2020 requesting Ministry of Environment and Association of Banks in Cambodia to assign representatives to participate in the consultative workshop were sent and received. Ministry of Environment received the letter on 28 October 2020

<sup>3</sup> Letters from The NGO Forum on Cambodia dated on 12 November 2020 requesting Ministry of Environment (MoE) and Association of Banks in Cambodia (ABC) for final feedbacks on the drafted report were sent and received by both on 13 November 2020. Still there were no official comments on the report till its finalization.

## 4. Research Results

### 4.1 Investment Trends in Cambodia

The number of committed investments in Cambodia grew significantly since 2012, witnessing a 24% increase from USD 2.9 billion in 2012 to USD 3.6 billion in 2016 and continuing to increase 75 % in 2017.<sup>4</sup> In 2018, investment slightly increased by approximately 2%, and in 2019, investment increased remarkably by 45 % compared to 2018. Over the five-year period, local investors accounted for approximately 35% of total investments. Most committed investments were in the industrial and infrastructure sectors, which accounted for 53% of total investments in the last five years, followed by the tourism (41%) and agriculture sectors (6%).<sup>5</sup>

As of 2019, the level of investment was about USD 9.4 billion. Foreign direct investment also rose, with China having the most considerable investment at 39.55%, the British Virgin Islands (BVI) accounting for 4.93%, and Japan for 3.18%. These were followed by Thailand, Vietnam, Singapore, the United Kingdom, and the Republic of Korea, with less than 1 %. Of the USD 9.4 billion invested, China has invested USD 2.75 billion, Hong Kong USD 912.55 Million, and Japan USD 298.84 million.

Of the cumulative Foreign Direct Investment (FDI) approved from 1994 to 2019, the most significant share was from China (21.81 %), which in the early years was a source of extensive investment in infrastructure and resource development, including rubber and tourism.<sup>6</sup> China is followed by Korea at 6.16 % and the UK at 5.01 %. The other significant sources of investment are Malaysia (3.59 %), Japan (3.13 %), Hong Kong (3.05 %), Taiwan (1.77 %), Vietnam (2.31 %), Singapore (1.64 %) and Thailand (1.54 %), primarily from the garment industry.

Although Cambodia welcomes all domestic and foreign investment, some investment activities are prohibited as they can pose numerous current and future risks. *Section 1 of Annex 1 of Sub-Decree 111 on the Enforcement of the Law Amending the Cambodian Investment Law* specifies the prohibited projects for investment in Cambodia, listed below:<sup>7</sup>

- Production/processing of psychotropic substances and narcotic substances
- Production of poisonous chemicals, agricultural pesticide/insecticide, and other goods by using chemical substances, prohibited by international regulations or the World Health Organization, that affected the public health and environment
- Processing and production of electric power by using any waste imported from a foreign country
- Forestry exploitation business prohibited by Forestry Law
- Investment activities prohibited by law

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<sup>4</sup> Source: <http://www.cambodiainvestment.gov.kh/why-invest-in-cambodia/investment-environment/investment-trend.html> retrieved on 23 October 2020.

<sup>5</sup> Ibid.

<sup>6</sup> Source: <http://www.cambodiainvestment.gov.kh/why-invest-in-cambodia/investment-environment/investment-trend.html> retrieved on 23 October 2020.

<sup>7</sup> Ibid.

## 4.2 Business Overview in **Cambodia's** Finance and Banking Sector

As of 2019, the banking system in Cambodia includes:<sup>8</sup>

<b>N</b>	<b>Banking system in Cambodia</b>	<b>Number</b>
a.	Commercial banks (17 locally incorporated, 17 subsidiaries, 13 foreign branches)	47
b.	Specialized banks	15
c.	Microfinance deposit-taking institutions	7
d.	Microfinance institutions	76
e.	Rural credit institutions	245
f.	Leasing companies	15
g.	Third-party processors	4
h.	Payment service institutions	21
i.	Credit reporting system service provider	1
j.	Representative offices of foreign banks	6
k.	Foreign exchange dealers.	2,913

The banking sector has continued to grow impressively. Single banking institutions accounted for 83.2% of the banking system's total assets in Cambodia. Total assets of the banking institutions increased by 21.5% to 172.1 trillion riels (USD 42.2 billion) with 103.6 trillion riels (USD 25.4 billion) in customer deposits. The shareholders' fund is 32.9 trillion riels (USD 8.1 billion), and the lending fund is 4.5 trillion riels (USD 1.1 billion).<sup>9</sup> Overall, the banking sector keeps improving remarkably, reflecting a 22.8% increase in total assets, equivalent to KHR 171 trillion (USD 41.8 billion).<sup>10</sup>

In Cambodia, there are 2,450 branches and headquarters, 2,520 ATMs, 7,587,048 deposit accounts and 3,066,880 loan accounts.<sup>11</sup> Moreover, banks and financial institutions have diversified their financial services more actively to enable their clients to use cards instead of cash, money transfers and electronic payments. However, Cambodia has been regarded as a "*predominantly cash economy*", and most Cambodians enjoy financial access but cannot save.<sup>12</sup>

Credit, the most crucial source of capital to spur economic activity, grew by 23.8 % (equivalent to KHR 100.5 trillion or USD 24.5 billion) and was provided to major economic sectors, including retail trade (16%), wholesale trade (11%), mortgage (10%), construction (10%), agriculture, forestry, and fishery (9%) etc.<sup>13</sup>

<sup>8</sup> The National Bank of Cambodia (2019). Financial Stability Review 2019. Directorate General of Banking Supervision. Phnom Penh. Cambodia.

<sup>9</sup> Ibid, p. 2

<sup>10</sup> Which was supported by customer's deposits KHR 104 trillion (US\$25.5 billion), capital KHR 20.4 trillion (US\$5 billion) and borrowing funds of KHR 4.9 trillion (US\$1.2 billion). Source: NBC (2019). Annual Report 2019. National Bank of Cambodia, Phnom Penh, Cambodia

<sup>11</sup> Ibid, p.15

<sup>12</sup> World Bank (2019). Microfinance and Household Welfare. Cambodia Policy Note. International Bank for Reconstruction and Development. Washington DC.

<sup>13</sup> NBC (2019). Annual Report 2019. National Bank of Cambodia, Phnom Penh, Cambodia (p.15-16)

According to the data in the CBC annual report (2018), as of 2018, more than three million people in Cambodia are currently receiving loans or credits from financial institutions amounting to USD 20.854 million.<sup>14</sup>

Of those people, 57% are women, and 17% of lenders have relationships with more than one financial institution.

Regions	Financial Institutions	Outstanding Balance (in million US Dollars)	Active Borrowers (in thousands)
Tonle Sap Region	134	4,586.73	1,003.34
Plain Region	150	14,369.01	1,851.45
Plateau Region	113	770.88	208.02
Coastal Region	124	1,127.09	218.39
Total	157	20,854	3,281.19

Table 1: The 2018 Credit Market Situation in Cambodia


<b>Credit</b>	U.S. Dollar	91 %	
	Khmer Riel	8 %	
	Thai Baht	1 %	
<b>Types of Credit</b>	Small Business	61 %	
	Personal Finance	15 %	
	Mortgage	14 %	
	Agricultural Loan	8 %	
	The Other Loans	2 %	

Table 2: Distribution of the Cambodian Credit Market by size and currency (2018)

Source: CBC, 2018

**Credit Bureau Cambodia (CBC)** is a privately held company established in 2012 with the aim of strengthening credit information sharing and promoting transparency to reduce credit risks and lower interest rates. CBC is a joint venture between the ABC, the Cambodian Microfinance Association, ACLEDA Bank Plc., Union Commercial Bank Plc., and First Commercial Bank with a total investment of 51% and the other 49% from EQUIFAX CAMBODIA HOLDING PTE LIMITED.<sup>15</sup> As of December 2018, CBC has 157 member institutions, including banks, microfinance institutions, leasing companies, and rural credit institutions. CBC collects credit data of individuals throughout the country from member banking and financial institutions and shares this information and data back to them for their related activities, such as credit history assessments (the borrowed amount, lending institutions, declared income, and customer details). In 2018, all member institutions provided loans totalling USD 20.85 billion to 3.82 million people.<sup>16</sup>

<sup>14</sup> CBC (2018). Annual Report 2018. Credit Bureau Cambodia. Phnom Penh. Cambodia.

<sup>15</sup> CBC (2018). Annual Report 2018. Credit Bureau Cambodia. Phnom Penh. Cambodia.

<sup>16</sup> CBC (2018). Loan Situation in Cambodia Report 2018. Credit Bureau Cambodia. Phnom Penh. Cambodia



## 4.3 Legal Framework of the Environmental and Finance-Banking Sectors in Cambodia

### 4.3.1 Environmental Sector (Environmental Impact Assessment)

- *Law on Environmental Protection and Natural Resource Management*, adopted and promulgated in 1996, clearly specifies the requirements for environmental impact assessments for public or private projects and existing and ongoing activities (which are still unaffected) (Chapter 3). The Ministry of Environment is the only body in charge of monitoring and advising on environmental impact assessments.
- *Sub-decree no. 72 ANKR.BK on Environmental Impact Assessment Process* signed and entered into force in 1999 for:
  - a. determining the environmental impact assessment of private and public projects and activities
  - b. defining the type and scope of the proposed action plan as well as existing and ongoing activities of both private and public entities
  - c. encouraging public participation in the environmental impact assessment process.

The sub-decree sets out:

- a. the responsible institutions (*Chapter 2*)
  - b. the environmental impact assessment requirements for the proposed project (*Chapter 3*)
  - c. the procedures for the environmental impact assessment process for the proposed project (*Chapter 4*)
  - d. procedures of environmental impact assessment process for existing activities (*Chapter 5*)
  - e. conditions for project approval (*Chapter 6*)
  - f. provisions on penalties (*Chapter 7*).
- *Declaration no. 376 BRK.BST on General Guidelines for Preparing Initial and Full Environmental Impact Assessment Reports* was introduced in 2009. The declaration aims to implement the general guidelines on preparing the initial and final environmental impact assessment reports and summary tables as attached in its appendix. Once again, it reminds us of the need for environmental impact assessments for private companies, state-owned enterprises, mixed state-owned enterprises, and existing and ongoing activities. However, this declaration sets out the exceptions that do not require environmental impact assessment for any projects of particularity and urgency as decided by the Royal Government of Cambodia (*Article 2*).
  - *Declaration no. 021 BRK.BST on the Classification of Environmental Impact Assessments for Development Projects* was promulgated in 2020. The declaration aims to facilitate and guide private and public development projects in efficiently implementing environmental impact assessments.

It classifies environmental impact assessments for development projects that may require:

- a. environmental protection contracts
  - b. initial environmental-social impact assessment reports
  - c. full environmental-social impact assessment reports.
- In addition to the above-mentioned legal standards, the MoE has also implemented the sub-decree related to pollution and its control.<sup>17</sup> Another declaration on the introduction of ideal working conditions for projects in the domains of infrastructure and tourism development, agro-industrial plantations, factory and handicraft, construction and river sand, and stone and construction materials was implemented in 2018.

#### **4.3.2 Finance and Banking Sector**

- *Law on foreign exchange*, promulgated by a Royal Kram no. CS/RKM/0897/03 dated 22 August 1997, aims to apply to all currency transactions and, in general, all operations involving residents and non-residents in terms of:
- a. trade settlements
  - b. remittances
  - c. capital movements, including investments.
- *Law on negotiable instruments and payment transactions*, promulgated by a Royal Kram no. NS/RKM/1005/030 dated 25 October 2005 governs the instruments that can be traded and settled transactions, including bank accounts and the operation of payment systems. A negotiable instrument refers to a written order or a promise to pay a determinate sum of money, transferable by delivery, and where required, also with an endorsement. The negotiable instruments governed by this law include checks, bills of exchange and promissory notes.
- *Law on commercial enterprises*, promulgated by a Royal Kram no. NS/RKM/0605/019 dated 19 June 2005 defines the forms of partnerships and companies carrying out business in the Kingdom of Cambodia. A partnership includes both general and limited partnerships. A company comprises both private limited and public limited companies.
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- *Law on anti-money laundering and terrorism financing*, promulgated on 27 June 2020 by a Royal Kram no. NS/RKM/0620/021, dated 27 June 2020, aims to combat money laundering and terrorism financing by adopting measures to control, prevent, stop, suppress, and eliminate them.
- *Declaration on minimum registered capital of banks and financial institutions (Prakas no. B7-017-117 dated 22 March 2016)* aims to redefine the minimum registered capital for banking and financial institutions. Under article 4 of this declaration, a commercial bank

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<sup>17</sup> Sub-decree no. 27 on water-pollution control (1999), Sub-decree no. 42 on air pollution control and noise disturbance (2000), Sub-decree no. 235 on the management of drainage system and wastewater treatment systems (2017). Sub-decree no. 118 on management of garbage and solid waste of downtowns (2015).

incorporated as a local company, or a foreign bank subsidiary shall have a minimum registered capital of KHR 300,000,000,000 (three hundred billion Riels). A commercial bank incorporated as a branch of a foreign bank whose parent bank is rated “investment grade” by an international independent rating agency, shall have a minimum registered capital of KHR 200,000,000,000 (two hundred billion Riels) (Article 3, Paragraph 1). A specialized bank established under the guise of a local company shall have a minimum registered capital of 60,000,000,000 Riels (sixty billion Riels) (Article 5).

- *Law on financial lease*, promulgated by a *Royal Kram no. NS/RKM/0609/008, dated 20 June 2009*, aims to determine the rights and duties of all parties involved in the financial lease operations and take actions to protect those rights. Its objective is to develop the banking and financial system and enterprises to carry out equal, safe, effective, and productive financial lease operations in accordance with the evolution of the economy of the Kingdom of Cambodia.
- *Code of Banking Practice (2015)*, introduced by the ABC, emphasizes the criteria for providing credit to customers. Its clause 12.1 recommends that the bank conduct diligent and prudent operations in assessing customers’ ability to repay credit facilities. It sets out five criteria to check information and data to study credit repayment ability.<sup>18</sup> The code and the requirements for pre-lending assessment do not emphasize or consider environmental and social issues that may affect the client’s business and that these impacts may affect and reduce the client’s ability to repay the loan.
- *The Sustainable Finance Principles* of the ABC were officially announced on March 29, 2019, with the participation of 48 member banks.<sup>19</sup> The principles have the following main objectives:
  - Properly establish and implement environmental and social risk management
  - Sustainably develop and promote business opportunities
  - Integrate sustainability into the banking business
  - Collaborate with all stakeholders, including governments, authorities, investors and international partners
  - Provide capacity development and knowledge sharing.

With the above principles, the National Bank of Cambodia and the Banking Association of Cambodia signed a joint Memorandum of Understanding<sup>20</sup> with the Ministry of Environment on July 31, 2019, to formally define cooperation between the three parties in contributing to environmental protection, natural resource management and climate change that could affect the banking sector in Cambodia. This MoU is a testament to the solidarity and contribution, responsibility, and commitment to achieving the goals of equitable and sustainable development.

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<sup>18</sup> The five criteria include (1) income and financial commitments, (2) prior knowledge of customer’s financial affairs, (3) information obtained from credit agencies, including Credit Bureau Cambodia, (4) credit assessment techniques such as credit scoring and (5) security provided, if any.

<sup>19</sup> The National Bank of Cambodia (2019). *Financial Stability Review 2019*. Directorate General of Banking Supervision. Phnom Penh. Cambodia.

<sup>20</sup> *Ibid*, p.6

It sets out the following key commitments:

- Collaborate and assist each other to build capacity and raise awareness of officials, staff and individuals involved in sustainable financial practices
- Share information and documents related to sustainable financial practices
- Collaboratively organize a program to raise public awareness of sustainable financial principles
- Technical collaboration and assistance in developing and implementing sustainable financial principles
- Provide cooperation and coordination with relevant organizations or institutions to develop and implement sustainable financial policies.

## 4.4 Practices of Compliance on Environmental and Social Guidelines of the International Banks

In the last 30 years, banks and funding agencies have developed and implemented strategic regulations, policies, and strategies to identify and integrate the environmental and social risks in their work to support responsible economic development. The safeguard policies are the wider mechanism required by top management. Such policies will help prioritize the environmental and social issues in decision-making, provide technical concepts and tools to assist the development process and promote public participation and transparency in development.

### 4.4.1 World Bank (WB)

The World Bank will classify all projects (including projects involving Financial Intermediaries (FIs)) into one of four classifications:<sup>21</sup>

- **High Risk**
- **Substantial Risk**
- **Moderate Risk**
- **Low Risk**

In determining the appropriate risk classification, the Bank will consider relevant issues, such as the type, location, sensitivity, and scale of the project; the nature and magnitude of the potential environmental and social risks and impacts; and the capacity and commitment of the borrower (including any other entity responsible for the implementation of the project) to manage the environmental and social risks and impacts in a manner consistent with the ESSs. Other risk areas may also be relevant to the delivery of social and ecological mitigation measures and outcomes, depending on the specific project and context. These could include legal and institutional considerations, the nature of the proposed mitigation and technology; governance structures and legislation; and concerns relating to stability, conflict, or security.

World Bank will require borrowers to use different methods and tools<sup>22</sup> to carry out the environmental and social assessment and document the results of such evaluations, including the mitigation measures to be implemented<sup>23</sup>. These methods are:

1. **Environmental and Social Impact Assessment (ESIA)**
2. **Environmental and Social Audit (ESA)**
3. **Hazard or Risk Assessment (H&RS)**
4. **Cumulative Impact Assessment (CIA)**
5. **Social and Conflict Analysis (SCA)**
6. **Environmental and Social Management Plan (ESMP)**
7. **Environmental and Social Management Framework (ESMF)**
8. **Regional ESIA (RESIA)**
9. **Sectoral ESIA (SESIA)**
10. **Strategic Environmental and Social Assessment (SESA)**

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<sup>21</sup> World Bank (2017). The World Bank Environmental and Social Framework. International Bank for Reconstruction and Development. Washington, DC

<sup>22</sup> Ibid, p. 23-24

<sup>23</sup> Ibid, p.8

The World Bank has set up and approved ten **Environmental and Social Standards (ESSs)** as conditions that borrowers must apply to identify and assess the risks and impacts on the environment and communities from any project financed by the World Bank. The World Bank believes that using these standards, by focusing on the identification and management of environmental and social risks, will support borrowers in their goal to reduce poverty and sustainably increase prosperity for the benefit of the environment and their citizens.

The standards will:<sup>24</sup>

- a. support Borrowers in achieving good international practice relating to environmental and social sustainability
- b. assist Borrowers in fulfilling their national and international environmental and social obligations
- c. enhance non-discrimination, transparency, participation, accountability, and governance
- d. enhance the sustainable development outcomes of projects through ongoing stakeholder engagement.

The effective implementation of the following Environmental and Social Standards (ESSs) is just like a *license to execute the project* in the context of sustainable development:

<b>Standard</b>	<b>Description</b>
Environmental and Social Standard 1 (ESS1):	Assessment and Management of Environmental and Social Risks and Impacts
Environmental and Social Standard 2 (ESS2):	Labour and Working Conditions
Environmental and Social Standard 3 (ESS3):	Resource Efficiency and Pollution Prevention and Management
Environmental and Social Standard 4 (ESS4):	Community Health and Safety
Environmental and Social Standard 5 (ESS5):	Land Acquisition, Restrictions on Land Use and Involuntary Resettlement
Environmental and Social Standard 6 (ESS6):	Biodiversity Conservation and Sustainable Management of Living Natural Resources
Environmental and Social Standard 7 (ESS7):	Indigenous Peoples/Sub-Saharan African Historically Underserved Traditional Local Communities
Environmental and Social Standard 8 (ESS8):	Cultural Heritage
Environmental and Social Standard 9 (ESS9):	Financial Intermediaries
Environmental and Social Standard 10 (ESS10):	Stakeholder Engagement and Information Disclosure

**Environmental and Social Standard 1 (ESS1)** applies to all projects that seek Bank Investment Project Financing. ESS1 establishes the importance of:

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<sup>24</sup> World Bank (2017). The World Bank Environmental and Social Framework. International Bank for Reconstruction and Development. Washington, DC (p. 8)

- a. the Borrower's existing environmental and social framework in addressing the risks and impacts of the project
- b. an integrated environmental and social assessment to identify the risks and impacts of a project
- c. effective community engagement through disclosure of project-related information, consultation, and effective feedback
- d. management of environmental and social risks and impacts by the borrower throughout the project life cycle.

The World Bank requires that all environmental and social risks and impacts of the project be addressed as part of the environmental and social assessment conducted per ESS1.

ESSs 2–10 set out the borrower's obligations in identifying and addressing environmental and social risks and impacts that may require particular attention. These Standards establish objectives and requirements to avoid, minimize, reduce, and mitigate risks and consequences and compensate for and offset remaining significant residual impacts.

To identify the project's impacts, the Bank will classify all projects (including projects involving Financial Intermediaries (FIs) into one of four classifications: High Risk, Substantial Risk, Moderate Risk or Low Risk. In determining the appropriate risk classification, the World Bank will consider relevant issues, such as the type, location, sensitivity, and scale of the project; the nature and magnitude of the potential environmental and social risks and impacts; and the capacity and commitment of the Borrower (including any other entity responsible for the implementation of the project) to manage the environmental and social risks and impacts in a manner consistent with the ESSs. Other areas of risk may also be relevant to the delivery of environmental and social mitigation measures and outcomes, depending on the specific project and the context in which it is being developed. These could include legal and institutional considerations, the nature of the mitigation and technology being proposed; governance structures and legislation; and considerations relating to stability, conflict, or security.

Besides, the World Bank has issued the **Environmental, Health and Safety (EHS) Guideline**. This guideline is a technical reference that is general and specific, for instance, good international industry. This guideline delineates both general and specific levels and executive measures for all sectors and industries such as emissions, wastewater, waste management, energy efficiency, safety, and welfare of the communities.

These policies and guidelines provide the banks themselves, funding agencies, the borrower (government), civil society, private sector, consultants, and other stakeholders the guidance to implement them for project procedures, technical aspects for project planning and resolution mechanisms, and the actual implementation in response to any impacts from the projects financed by the World Bank.<sup>25</sup>

#### **4.4.2 International Finance Corporation (IFC)**

In 2006, IFC - a member of the World Bank Group - adopted the **Performance Standards (PS) on Social and Environmental Sustainability** for private sector companies that received IFC funding

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<sup>25</sup> World Bank. (2004). *Involuntary Resettlement Sourcebook. Planning and Implementation in Development Projects*. The World Bank

(IFC, 2009).<sup>26</sup> Initially, the standards were considered aspirational guidelines and were treated as an international benchmark for private sector projects. However, in the context where the IFC becomes a lender, they are no longer just a good practice benchmark but have become compliance standards and now operate as a risk management tool for IFC- funded projects. The IFC standards are also increasingly seen as a global benchmark.

#### 4.4.3 Asian Development Bank (ADB)

The **Safeguard Policy Statement (SPS)** of the Asian Development Bank was modified and approved officially in 2009. It aims to manage environmental and social resources risks resulting from the ADB-financed projects.

The objectives of this SPS are to:<sup>27</sup>

- i. avoid adverse impacts of projects on the environment and affected people where possible
- ii. minimize, mitigate, and/or compensate for adverse project impacts on the environment and affected people where avoidance is not possible
- iii. support borrowers/clients in strengthening their safeguard systems and develop their capacity to manage the environmental and social risks.

There are three central environmental safeguard policies that are regularly updated:

- i. Policy on Involuntary Resettlement (1995)
- ii. Policy on Indigenous Peoples (1998)
- iii. Environmental Policy (2002)

The updates of these policies are to:<sup>28</sup>

- i. better articulate the safeguard policies to improve their clarity, coherence, and consistency
- ii. balance a front-loaded procedural approach with one also focused on results during implementation
- iii. adapt policy implementation to an evolving range of lending products and innovative financing modalities
- iv. work toward greater harmonization with safeguard practices across MFIs and tailor safeguard approaches to different clients with varying capacities
- v. improve internal processes and resource allocation.

In pursuit of these policies' objectives, ADB adopts a set of specific **safeguard requirements** that borrowers or clients must meet in addressing environmental and social risks during the project preparation and implementation.

These safeguard requirements include:<sup>29</sup>

- Safeguard Requirement 1: Environment

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<sup>26</sup> IFC. (2009). IFC's Policy and Performance Standards on Social and Environmental Sustainability and Policy on Disclosure of Information: Report on the First Three Years of Application: International Finance Corporation.

<sup>27</sup> ADB (2020). Effectiveness of the 2009 Safeguard Policy Statement. Asian Development Bank. Manila. The Philippines

<sup>28</sup> ADB (2009). Safeguard Policies Statement, 2009. Asian Development Bank. Manila. The Philippines

<sup>29</sup> Ibid, p. 28



- Safeguard Requirement 2: Involuntary Resettlement
- Safeguard Requirement 3: Indigenous Peoples
- Safeguard Requirement 4: Special Requirements for Different Finance Modalities

ADB will not finance projects that do not comply with its safeguard policy statement, nor will it finance projects that do not adhere to the host country's social and environmental laws and regulations, including those laws implemented by the host country under international law obligations.<sup>30</sup> In addition, ADB will not finance activities on the prohibited investment activities list.

**Policy implementation:** ADB will carry out project screening and categorization at the earliest stage of project preparation when sufficient information is available for this purpose. (Table 3) Screening and categorization are undertaken to:

- reflect the significance of potential impacts or risks that a project might present
- identify the level of assessment and institutional resources required for the safeguard measures
- determine disclosure requirements.

Category	
A	A proposed project is classified as category A if it is likely to have significant adverse environmental impacts that are irreversible, diverse, or unprecedented. These impacts may affect an area larger than the sites or facilities subject to physical works. An environmental impact assessment is required
B	A proposed project is classified as category B if its potentially adverse environmental impacts are less adverse than those of Category A projects. These impacts are site-specific, few if any of them are irreversible, and in most cases, mitigation measures can be designed more readily than for category A projects. An initial environmental examination is required.
C	A proposed project is classified as category C if it is likely to have minimal or no adverse environmental impacts. No environmental assessment is required, although environmental implications need to be reviewed.
FI	A proposed project is classified as category FI if it involves the investment of ADB funds to or through a FI

*Table 3: Asian Development Bank-Environmental Categorization*

Source: ADB (2009)<sup>31</sup>

In addition, ADB also screens all projects to determine whether they involve involuntary resettlement. A resettlement plan will be prepared for a project involving involuntary resettlement that is commensurate with the extent and degree of the impacts, determined by the scope of physical and economic displacement and the vulnerability of the affected persons.

Similarly, ADB will screen all projects to determine whether they can potentially affect indigenous peoples, and an indigenous people plan will be prepared for such projects. The plan's level of

<sup>30</sup> Ibid, 2009

<sup>31</sup> ADB (2009). Safeguard Policies Statement, 2009. Asian Development Bank. Manila. The Philippines

detail and comprehensiveness will be commensurate with the degrees of impact, determined by evaluating:

- a. the magnitude of the impact on indigenous peoples' customary rights of use and access to land and natural resources, socioeconomic status; cultural and communal integrity; health, education, livelihood systems, and social security status; or indigenous knowledge
- b. the vulnerability of the affected indigenous peoples.

## 4.5 Finance and Banking Institutions in Cambodia

### 4.5.1 The National Bank of Cambodia (NBC)

*Royal Kram no. NS/RKM/0196/27* dated 26 January 1996 promulgated the law on the organization and functioning of the National bank of Cambodia and *Royal Kram no.NS/RKM/1206/036* dated 29 December 2006 promulgated the law on the amendment of articles 14 and 57 of the law.

The following description and discussion are based on the provisions and statements in the above laws:

#### **A) Mission of the National Bank of Cambodia**

The National Bank of Cambodia, also known as the “Central Bank”, is a commercial and industrial autonomous public institution. Its main mission is to set and lead monetary policy to maintain price stability to contribute to the economic development within the political, economic, and financial frameworks of the Kingdom of Cambodia. The Central Bank is a legal entity capable of:

- a. lending money, borrowing money from others, and entering various contracts
- b. suing and defending before the courts
- c. procuring, occupying, and transferring movable and immovable properties for the purpose of doing its business.

In addition, it has the right to issue declarations, regulations, circulars, and other instructions to fulfil its mission and implement the contents of this law. It regularly issues monetary policies (monetary, credit, interest, interest rates) and statistics relating to monetary quantities, fees, credits, balances, and exchange rates.

Through prudent monetary policy, inflation has been kept low at an average annual rate of less than 5%, which is appropriate for developing countries. However, in the context of a highly dollarized economy, the effectiveness of monetary policy implementation remains limited when the NBC does not have sufficient capacity to act as a final lender. At the same time, the NBC is developing additional monetary policy tools through the issuance of tradable securities, the development of interbank and monetary markets, and the strengthening of the use of Riel, to strengthen fiscal policy.

Laws applicable to banking and financial institutions are as follows:

- *Law On Financial Lease (2009)*
- *Law On Anti-Money Laundering and Terrorism Financing (2020)*
- *Law On Commercial Enterprises (2005)*
- *Law On Negotiable Instruments and Payment Transactions (2005)*
- *Law On Banking and Financial Institutions (1999)*
- *Law On Foreign Exchange (1997)*
- *Law on the amendment of articles 14 and 57 of the law on organization and functioning of the national bank of Cambodia (2006)*
- *Law On Organization and Functioning of The National Bank Of Cambodia (1996)*

## **B) General Functions and Duties of the National Bank of Cambodia**

The general functions and duties of the Central Bank are as follows:

- To determine the monetary policy objectives in consultation with the Royal Government and within the framework of economic and financial policies of the Kingdom of Cambodia
- To formulate, implement and monitor monetary and exchange policies aimed at the determined objectives
- To conduct regular economic and monetary analyses, disseminate the results and propose measures to the Royal Government
- To license or de-license the businesses of banking and financial institutions and other relevant establishments such as auditors and liquidators, as well as issuing regulations and monitoring these organizations
- To oversee payment systems in the Kingdom of Cambodia and to enhance interbank payments
- To act as the sole issuer of the national currency of the Kingdom of Cambodia
- To undertake and perform in the name of the Kingdom of Cambodia the transactions resulting from the engagement of the Kingdom of Cambodia with the public international organizations in the banking, credit, and monetary spheres
- To establish the balance of payments
- To participate in the management of external debts and claims
- To participate in the formation and supervision of the money and financial markets
- To license or de-license the institutions involving the businesses of foreign exchange, furniture, precious metals, and metals
- To set exchange rates.

## **C) Management of the Central Bank**

The following structures govern the Central Bank:

1. The governing body of the Central Bank is the Board of Directors, which a Governor heads. The Board consists of 7 members, including the Governor, a deputy governor and other five members, one each being a representative of the head of the Royal Government and the Ministry of Economy and Finance, and one each representing a financial activity, higher education, and the Central Bank's staff. In their positions, the governor and deputy governor cannot be civil servants, advisers to public entities, members of the Royal Government, and the National Assembly. The above conditions also apply to other members, except for the head of the Royal Government and the Ministry of Economy and Finance and representatives of higher education, each of whom can retain the status of a civil servant.
2. The Board of Directors are responsible for:
  - a. establishing the policies for the operations of the Central Bank
  - b. issuing decisions, regulations, circulars, and other directives to regulate the business of the Central Bank
  - c. setting the internal rules and regulations
  - d. designing the statute of staff
  - e. establishing the subordinate departments of the Central Bank
  - f. forming an auditing committee

- g. a staff training committee.
3. The Governor serves as the chief executive officer of the Central Bank and is responsible to the Board of Directors for implementing its policies. S/he shall be responsible for the conduct of the business of the Central Bank and have authority to act in all matters that are not, by this law and other relevant, specified for the Board.
  4. The deputy governor exercises such powers and carries out such duties as determined by the Governor. The deputy governor shall act as a governor in the governor's absence. The Governor and deputy governor are appointed, replaced, and dismissed by a royal decree on the recommendation of the Royal Government. The other members of the Board are appointed, replaced, and dismissed by a sub-decree. They are selected from a list prepared by the Governor with the names of three candidates for each post. The members of the Board are persons of recognized experience or standing in economic or financial matters and are at a maximum of sixty-five years of age. They are appointed for four years and may be re-appointed for only one more term. As for the first Board of Directors, which is created under this law, except for the Governor, deputy governor, and a member representing the Central Bank's staff, two of the members shall serve for two years from the date of appointment of the first Board. Members of the Board and their families must not be shareholders of any banking and financial institutions regulated by the Central Bank.

A member of the Board shall cease to hold an office if s/he:

- a. is convicted of a criminal, administrative offence, or a violation of economic or commercial law
- b. is determined by the Board to have violated the prohibition of articles 15 and 16 of this law
- c. is absent for four consecutive meetings, except for illness or the case of force majeure recognized by the Board
- d. resign by written notice
- e. is physically and mentally incapacitated from performing their duties
- f. is determined to be bankrupt by the court.

The Board's meeting shall be held at least once every two months. Board members shall receive an attendance allowance, the amount of which shall be fixed by the Board. The Governor and deputy governor shall receive base remuneration from the Central Bank in the same amount as that of the member of the Royal Government.

No officer, employee, or member of the Central Bank shall:

- receive any benefit related to commercial, financial, agricultural, industrial, or other
- business interest
- accept directions from these interests in respect of duties to be performed under the law
- put themselves in a position where their interest conflicts with their duties
- receive any gift or advantage for themselves or persons with whom they

have a family, business, or financial connection diminishes their honesty in their conduct of duties.

Board members shall fully disclose to the Board their significant commercial, financial, agricultural, industrial, or other business interests with which they or members of their immediate family may have, directly or indirectly, at any time, and shall refrain from voting rights on any matter related to that. However, they may be qualified to constitute a quorum per the internal procedures of the Board. Except when under the provisions of any law, or when required to do so by any court of law, officers, employees, or members of the Board of the Central Bank shall not disclose to any person any material information related to its confidentially professional affairs which they have acquired in the performance of their duties.

#### **D) Autonomy of the Central Bank**

To accomplish its mission, the Central Bank shall be permanently empowered and shall have operating autonomy and submit reports of its mission's implementation and results to the National Assembly and the Royal Government. The Governor of the Central Bank may address meetings of the Council of Ministers at the invitation of the Council of Ministers. The Minister or the Secretary of State of the Ministry of Economy and Finance may address meetings of the Board of Directors of the Central Bank at the invitation of the Board. The Governor or members of the Board shall appear before the National Assembly or a standing committee thereof to explain the policies of the Central Bank or comment on proposed legislation at the request of the National Assembly.

At the end of each semester, the Central Bank shall deliver to the National Assembly and the Royal Government:

- (a) An assessment in general terms of the economic and financial condition of the Kingdom of Cambodia and a description of the monetary and exchange policies that the Central Bank proposes to follow during the next semester and for a longer period as the Central Bank may decide
- (b) A review and assessment of the implementation of monetary and exchange policy during the period to which the last preceding semester statement relates. Despite the above report, Central Bank makes a report required by the National Assembly and Government.

#### **E) Financial Relations with Public Entities**

The Central Bank shall be solely responsible for granting or revoking licenses and supervision of banking and financial institutions and other organizations as provided in Article 7 of the law on the organization and functioning of the National Bank of Cambodia (1996 and its amendment in 2006).

The Central Bank may:

- Issue such decisions, regulations and other directives, and take such other actions as it shall deem necessary to execute its powers and responsibilities

under Title II of this law, though proper licensing and de-licensing thereof and supervisory standards and enforcement procedures.

- Appoint, at its discretion, its officers or any other qualified persons to regularly inspect any banking or financial institution and to examine its books, records, documents and accounts.
- Require an officer or employee of a banking or financial institution to furnish to the Central Bank such information as requested for supervision and regulation.
- Take remedial action or sanction according to the existing laws if there has been an offence by a banking or financial institution or its officers or employees concerning:
  - a. the violation of provisions of the current laws or regulations of the Central Bank
  - b. the breach of fiduciary duty
  - c. the failure to follow monetary policy measures or prudential regulations.

The Central Bank may open accounts for and accept deposits from banking and financial institutions carrying out business in the Kingdom of Cambodia under such terms and conditions, including the payment of interest and the establishment of charges as it may determine. The Central Bank may prescribe by publication or written notice to the main office in the Kingdom of Cambodia of each banking and financial institution the maintenance or required reserves. Such reserves shall be maintained by cash holding or special deposits in current accounts with the Central Bank.

It shall prescribe the same reserve ratios for similar liabilities. The total amount of reserves that the banking and financial institutions are required to hold shall be fixed with reference to the deposits and other similar liabilities with clients. Any prescription of, increase in the required reserve ratios shall be effective one month after written notice has been given to the banking and financial institution. The Central Bank may exclude certain classes of banking and financial institutions from maintaining reserves. It may impose on any institution which fails to maintain the required reserves a charge at the rate of 1/10 (one-tenth) of the latest refinancing rate set per day on the deficiency. Such a charge may be recovered by deducting from any balance of the institution with the Central Bank.

The Central Bank shall determine the procedure and purchase from, sell to, discount or rediscount for the banking and financial institution:

- a. Bills of exchange or promissory notes drawn or made for bona fide commercial, industrial or agricultural purpose, bearing two or more signatures, one of which must be that of a commercial bank and maturing within 90 days from the date of their acquisition by the Central Bank; however, provided that bills of exchange or promissory notes drawn or made to finance seasonal agricultural production or marketing of crops may mature within 210 days from the date of their issue
- b. Any government securities forming part of the public issue and maturing

- within 90 days from the date of their acquisition
- c. Any private negotiable claims on the money market as well as all banker claims bearing creditworthy signatures and appearing on a list recognized by the Board
  - d. The Central Bank's own securities. It shall fix and publicly announce its minimum rate for rediscounts, advances, repurchases or loans.

The Central Bank may establish different rates and ceilings for various such transactions or maturities classes. It may grant commercial banks advances on their current accounts, secured by government securities or government-guaranteed securities. The banking and financial institution shall comply with the written directives that the Central Bank may issue to it, collectively or on an individual basis, concerning its balance sheet account, off-balance-sheet commitments, and business accounts involving:

- a. the minimum capital
- b. the minimum amount of net worth of a banking and financial institution
- c. the prohibition, restrictions, conditions, other provisions.

The banking and financial institutions that engage in similar activities and are in comparable financial conditions shall be subject to similar regulations. They must furnish the Central Bank with such information and data as required for performing its functions. The Central bank may publish such information and data, as a whole or in part, in an aggregate form for classes of banking and financial institutions determined per the nature of their business whilst maintaining business confidentiality. It is responsible for promoting interbank services such as risk centralization and unpaid loans. In cooperation with commercial banks, the Central Bank may establish a clearinghouse for the prompt and efficient clearing and settlement of interbank payments.

#### **4.5.2 The Association of Banks in Cambodia (ABC)**

The Association of Banks in Cambodia (ABC) was formed in 1994 and is recognized by the Royal Government as the official organization to represent the country's private banking sector. Its purpose is to promote constructive dialogue amongst member banks and serve as an industry voice to the public and the Royal Government. Its missions are to participate in the development of the Cambodian financial system and protect its members' legitimate interests. With this mission, the ABC has set 19 specific objectives, of which the 14th objective is to promote active participation in social activities and corporate social responsibility programs (CSR).<sup>32</sup>

The members of the ABC include 44 local and foreign banking institutions and branches. The association arranges meetings at least once a month or more to address critical challenges. In addition, it has set up several committees to be responsible for any specific roles and issues. Since 1998, it has become an active member of the Association of ASEAN Banks and has participated in all activities and events organized.

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<sup>32</sup> Source: ABC <https://www.abc.org.kh/our-profile> retrieved on 14 October 2020.



The ABC has set up an initiative on the Cambodian Sustainable Finance Initiative (CSFI), which was officially announced in September 2016 for two years under the auspices of USAID, Pact, WCS, and Mekong Strategic Partners, in collaboration with the NBC and the MoE.<sup>33</sup> This initiative aims to develop and strengthen the protection and risk management standards in the financial sector related to the environmental impact caused by the private sector. As a result of these collaborations, the ABC has developed a sustainable fiscal policy, which focuses on environmental protection, the preservation of culture, traditions, history, and social values existing in Cambodia. The principles are intended to develop and establish appropriate ecological and social standards for Cambodia.

For the protection of the environment, citizens, and heritage property, this policy sets out several key points, such as:<sup>34</sup>

- The association will assess and manage environmental risks related to climate change, pollution, waste management and protection of vulnerable natural resources.
- The association will assess and manage risks that may adversely affect people, especially rural communities, workers, indigenous peoples, and cultural heritage, including language, culture, traditions, and historical sites.
- The association will assess and manage risks that may have a severe negative impact on heritage, including language, culture, traditions, and other monuments.

#### **4.5.3 Finance and Banking Institutions in Cambodia**

Finance and banking institutions must comply with sound and prudent credit policies by conducting general operations and loan procedures that must be appropriately approved and reviewed by management and/or the Board of Directors. All banking and financial institutions must establish:

- i. Written policies and procedures for formulating credit policies and procedures and defining the lending authority of credit officers and/or credit committees and the Board of Directors. Those policies and procedures must be referred to the lending activities' staff.
- ii. All loan applications of the borrower must be up-to-date and reliable. Credit policy, loan procedures and authority must include credit analysis, credit approval process, periodic credit review procedures, credit approval limits of officers and/or credit committee, collateral, and other necessary information.<sup>35</sup>

The total weighted outstanding loans to related parties will, in no case, be more than 10% of the bank's net worth. Each banking and financial institution shall send a quarterly declaration of relevant loans to the NBC and make it copied for its Board of Directors. Any failure to abide by the present regulation will be sanctioned according to article 52 of the *Law on Banking And*

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<sup>33</sup> The initiative was made public on September 16, 2016 at the Himawari Hotel with the participation of about 60 people from banking institutions, the National Bank of Cambodia, the Ministry of Environment, USAID, Pact, WCS, and Mekong Strategic Partners and some other journalists. In the event, there was a signing ceremony between the Banking Association of Cambodia and Her Excellency Chea Serey, Director General of the National Bank of Cambodia under the testimony of His Excellency Eang Sopalet, Undersecretary of State of the Ministry of Environment.

<sup>34</sup> Source from the website of the Association of Banks in Cambodia <https://www.abc.org.kh/CSFI/sustainable-finance-initiative>, retrieved on 11 September 2020.

<sup>35</sup> Declaration No. B7-05-054 Prokor on loan policies, procedures and lending authority.

*Financial Institutions (1999)*.<sup>36</sup>

The related parties to the banking and financial institutions include the following:<sup>37</sup>

- a. any person holding directly or indirectly at least ten % (10%) of capital or voting rights
- b. any company of which the covered entity directly or indirectly holds at least ten % (10%) of the capital or voting rights
- c. any individual who participates in the administration, direction, management, or internal control
- d. the external auditors

### *Banking Institutions*

The banking sector in Cambodia is a two-tier system: the public sector (represented by the NBC) and the private sector, including commercial banks, specialized banks, microfinance institutions, and several participating NGOs in rural credit activities.

Under the *Law on Banking and Financial Institutions (1999)*, all banks must apply for a license and be under the supervision of the NBC. Some banks have not functioned well in the past few years due to weak management, causing customers to lose trust in the banking system. The NBC has implemented the Law On Banking and Financial Institutions and has re-licensed them to address this situation. Through implementing this new reform program, Cambodia's financial system has continuously developed and ensured high stability.

As of 2019,<sup>38</sup> the banking system in Cambodia consists of 47 commercial banks (17 local banks, 17 subsidiaries, 13 foreign bank branches) and 15 specialized banks. Of all the banking and financial institutions, commercial banks have been the essential payment service providers as they have benefited from the legal and institutional benefits of receiving deposits from the public. The bank deposits provide an important basis for non-cash payment transactions such as credit card transfers, direct debit, and card payments. In addition, commercial banks have deployed and managed payment infrastructure such as ATMs and POS machines.

### *Non-Banking Institutions*

In addition to banking institutions, there are also non-bank service providers acting as third-party processors. A third-party processor is an institution authorized by a bank to provide one or more types of payment services to customers. It is authorized through an agreement with a bank and must apply for a National Bank of Cambodia license. Under the law on negotiable instruments and payment transactions, a third-party processor may act on behalf of the bank with the following authorization:

- As a communication service provider
- As an interbank settlement that may transmit information on interbank payments, including the bank where the payment is completed

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<sup>36</sup> Declaration No. B7-01-137 Prokor on loans to related parties, amended by the declaration no. B7-02-146 dated 07 June 2002.

<sup>37</sup> Royal Kram no. NS/RKM/1199/13 promulgating the law on banking and financial institution, dated 18 November 1999.

<sup>38</sup> The National Bank of Cambodia (2019). Financial Stability Review 2019. Directorate General of Banking Supervision. Phnom Penh. Cambodia.

- As a provider of money transfer service by phone or other means
- As a manager or operating agent for a bank account or customers
- Senders or orders of sending payment sent or received by the bank.

The third-party processors must comply with all NBC regulations' requirements, conditions, and restrictions set forth. In this regard, the NBC issued a *Declaration on Third-Party Processors* in 2010. As of December 2014, there are six third party processors licensed by the National Bank of Cambodia: *Wing, Viettel, IME, Western Union, Money Gram, and Peggy*.

#### 4.5.4 Loan Purpose

The purpose of the loan is the primary cause the borrower uses to apply for a loan, such as to buy a house or condo, invest in construction projects, factories or large enterprises.<sup>39</sup> The loan purpose aims to help the lender (such as a bank) determine the borrower's risk level. Lenders use different loan policies for different loan purposes. Each loan purpose requires the borrowers to furnish various documents to support their loan. It is imperative that when the borrower is low risk, they also get low-interest rates and reasonable loan terms from the lender.

**Large exposure** is defined as the overall gross exposure resulting from banking and financial institutions' operations with one single beneficiary, where such exposure exceeds 10% of the institution's net worth.<sup>40</sup> Exposure refers to the highest of the following items (hereinafter referred to as a loan):

- a. the outstanding loan or commitment
- b. the authorized loan or commitment signature (Article 1).<sup>41</sup>

The banking and financial institutions shall always maintain a ratio not exceeding 20 % between their overall exposure resulting from their operations with each beneficiary and their net worth (Article 2). At the banking and financial institution's request, the NBC may increase the maximum ratio described in Article 2 of this declaration up to an extra-large exposure limit, which cannot exceed 35% of the net worth, under the following conditions:

- a. The banking and financial institution's financial condition is considered "*satisfactory*" by the NBC's internal rating or benefits from an "*investment grade*" rating by an international rating agency.
- b. The borrower's financial situation is robust, including good business perspectives, solvency, profitability, and management.

The banking and financial institution shall provide the NBC with audited financial reports, a credit analysis report and other related documents when applying for approval of exposures exceeding a ratio described in Article 2 of this declaration. It shall be required to always maintain a maximum balance of 300% between the total of their large exposures, as defined in Article 1 of this declaration, and their net worth.

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<sup>39</sup> Source: <https://www.newcastle.loans/mortgage-guide/whats-loan-purpose-why-lenders-need-to-know>, retrieved on September 25, 2020.

<sup>40</sup> Declaration no. B7-06-226 Prokor dated 03 November 2006 on controlling banks and financial institutions' large exposures.

<sup>41</sup> Ibid.

## 5. Discussion

Cambodia's finance and banking sector has rebounded from 1979 to the present. In 1996, 1998, and 1999, the Royal Government enacted critical regulations in the banking and financial sector. These sought to regulate and control banks and financial institutions, maintain the banking system's stability to strengthen public and investors' trust, and enhance efficiency, robustness, competitiveness, and high integration to maintain price stability in line with Cambodia's financial sector development strategy. It has contributed to ensuring investment while balancing the Cambodian economy. Separately, the Royal Government of Cambodia has accounted for the management of natural resources and the environment by establishing the Ministry of Environment in 1993 and introducing the Management of Natural Resources And Environmental Protection Law in 1996. Many other relevant legal norms followed this.

Significant investments or development projects require bank loans to ensure capital security for operations, whether in the country or abroad. In general, such large projects often pose risks and damage to the environmental and social resources in and around the project areas. The loan from banking and financial institutions also indirectly contributes to the impacts of projects that receive such loans.

### 5.1 Policy Gaps in the Environmental, Finance and Banking Sectors

However, promoting the implementation of ESIA obligations in the banking and financial sector is essential to further contribute to the prevention of pollution and the conservation of natural resources and the welfare of society. The banking and financial institutions have played an indispensable role in securing sources of capital for investments, some of which may have detrimental socio-ecological consequences in the projects' locations.

The study gathers some information and evidence on the status and fulfilment of ESIA obligations in the banking and financial sector, which can add to current awareness and augment the promotion of environmental promotion in this area. Here, we discuss the findings mentioned in the previous sections:

- Cambodia's legal framework has not yet paid attention to ecological and social issues and natural resource protection in the banking and finance sector. Past legislation aimed at sharpening technical work and improving the efficiency of managing ESIA's, with specific guidelines from the MoE, such as:
  - a) *Classification of Projects For The Study of ESIA's (Declaration no. 021)*
  - b) *Determination of Working Conditions for Sectoral Projects (Declarations no. 092, 116, 118, 119 and 120)*
  - c) *Preparation of ESIA report (Declaration no. 376)*
  - d) *Registration of Consulting Companies for The Study And Preparation of ESIA Report (Declaration no. 215)*
  - e) Other sub-decrees that contribute to the inspection of ESIA.

There is no legal basis or provision for the inclusion or integration of this assessment in Cambodia's banking and financial institutions' policies and practices. This shortcoming demonstrates the current need to begin considering the potential social and environmental impacts from financing development projects.

- Key environmental policies and laws include:
  - a) *The Law on Environmental Protection And Natural Resource Management (1996)*
  - b) *Sub-Decree No. 72 On Environmental Impact Assessment Process (1999)*
  - c) *The Declaration on The Preparation of The Environmental Impact Assessment Report (2009)* and other relevant regulations.<sup>42</sup>

They supplement the environmental impact assessment work and require all public and private projects to conduct ESIA's before project development. However, these provisions do not encourage and promote environmental protection requirements in the banking or financial sector, probably because the legislation was framed to prioritize economic development when Cambodia faced economic and political hardships.<sup>43</sup> As noticed from 1997 to 1998, Cambodia also underwent the challenging global and Asian financial crisis,<sup>44,45,46</sup> an armed civil war between political parties,<sup>47</sup> and the reconciliation process of all Khmer groups and allies.<sup>48</sup> Attracting investors to increase the nation's gross domestic product is a key priority for policymakers to create the necessary incentives and incentives that the Royal Government of Cambodia can provide.

Environmental legislation and protection of natural resources must also coordinate the issuance of rules and regulations according to difficult circumstances. To date, the Royal Government of Cambodia has sought to formulate more environmental policies and

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<sup>42</sup> The sub-decree on water pollution control (1999), the sub-decree on the control of air pollution and noise (2000), the sub-decree on drainage and wastewater treatment system management (2017), the sub-decree on urban waste and solid waste management (2015), Prakas on the use of terms of reference (TOR) for infrastructure development project and tourism sector, agro-industrial crop sector, factory and handicraft project, construction sand and sand business project, construction material stone business project (2018), and a declaration on the classification of environmental impact assessments for development projects (2020).

<sup>43</sup> Ministry of Environment was first established in 1993 and the Law on Environmental Protection and Natural Resource Management was enacted in 1996. The Sub-Decree no. 72 on EIA Process was then put into practice in 1999. These dates show that Cambodia was in the instable and not-fully-peaceful economic and political situation, i.e., Cambodia had internal civil war in the country. Until 1998, the Khmer Rouge management organization was dissolved and back-to-government integration of all Khmer Rouge militaries happened. It was marked as the official end of the internal civil war in Cambodia.

<sup>44</sup> Ngozi Okonjo-Iweala, Victoria Kwakwa, Andrea Beckwith & Zafar Ahmed (1999). Impact of Asia's Financial Crisis on Cambodia and Lao PDR. Finance & Development (3) 36. A Quarterly Magazine of the IMF and can be accessed through <https://www.imf.org/external/pubs/ft/fandd/1999/09/okonjo.htm>

<sup>45</sup> Hal Hill & Jayant Menon (2013). Cambodia: Rapid Growth with Institutional Constraints. Asian Development Bank, No. 331, Manila, the Philippines. (accessed through [https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=&cad=rja&uact=8&ved=2ahUKEwiT0u6ruK DwAhVLeHOK Hd2mC-kQFjAOegQIGxAD&url=https%3A%2F%2Fwww.adb.org%2Fsites%2Fdefault%2Ffiles%2Fpublication%2F30140%2Fecconomics-wp331-cambodia-rapid-growth.pdf&usg=AOvVaw18SH4\\_5nSlpnFS0egONSfq](https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=&cad=rja&uact=8&ved=2ahUKEwiT0u6ruK DwAhVLeHOK Hd2mC-kQFjAOegQIGxAD&url=https%3A%2F%2Fwww.adb.org%2Fsites%2Fdefault%2Ffiles%2Fpublication%2F30140%2Fecconomics-wp331-cambodia-rapid-growth.pdf&usg=AOvVaw18SH4_5nSlpnFS0egONSfq))

<sup>46</sup> Hem Sochet (2013). Impact of the Global Financial Crisis on Cambodian Economy at Macro and Sectoral Levels. CDRI Working Paper Series No. 72, Phnom Penh, Cambodia

<sup>47</sup> Peou, S. (1998). Cambodia in 1997: Back to Square One? Asian Survey, 38(1), 69-74. doi:10.2307/2645469

<sup>48</sup> An Sokkhoeurn (2010). Conflict Resolution in Cambodia. CICIP Working Paper Series No. 35. Cambodian Institute for Cooperation and Peace, Phnom Penh, Cambodia (accessed through [https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=&cad=rja&uact=8&ved=2ahUKEwjvYU7vK DwAhXOV30K Hb10CuYQFjAKegQICBAD&url=https%3A%2F%2Fcicp.org.kh%2Fwp-content%2Fuploads%2F2021%2F02%2FCICP-Working-Paper- No-35.pdf&usg=AOvVaw3GN1\\_3Y-Qt518mKwbagWZg](https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=&cad=rja&uact=8&ved=2ahUKEwjvYU7vK DwAhXOV30K Hb10CuYQFjAKegQICBAD&url=https%3A%2F%2Fcicp.org.kh%2Fwp-content%2Fuploads%2F2021%2F02%2FCICP-Working-Paper- No-35.pdf&usg=AOvVaw3GN1_3Y-Qt518mKwbagWZg))

considerations to fill in the shortcomings and gaps but has not amended or revised the existing legislation.

Despite the many efforts by the Royal Government of Cambodia and the Ministry of Environment, they have not yet fully addressed the need for environmental protection in the banking and financial sectors. Banks are under no legal obligations to protect the environment or conduct an ESIA study before approving large loans for projects that may have potentially severe environmental consequences.

Moreover, the work between the MoE, ABC, and the NBC on the consolidation of environmental protection in the banking and financial sector is yet to reach a clear starting point, other than a 2019 MoU between the MoE and the ABC. This MoU has not resulted in any concrete implementation or outcomes so far. Such deficits can be attributed to limited implementation funds, no concrete action plan, and the outbreak of COVID-19 since late 2019.

- Moreover, the banking and financial sector regulations have not stimulated the legal obligation for banking and financial institutions to set ESIA as the loan evaluation and approval condition. Several motives could explain such discrepancy:
  - a. The Cambodian banking and financial sectors have been through a haggard developmental environment between 1990-2000 when there was an acute need for higher foreign investments.<sup>49</sup> At the same time, banks were called upon to increase loan disbursements for Cambodians to start, build and expand their businesses and assets. These overwhelming incentives and facilitation for investors, including those in the banking and financial sector, continue to be the priorities of the Royal Government of Cambodia. Therefore there is a lax implementation of certain requirements in this situation, including ESIA.
  - b. Implementation of ESIA practices has been absent since the early years. For instance, *Sub-Decree No. 72* was released in 1999, three years after the enactment of the *Law on Environmental Protection and Natural Resource Management* in 1996. *Declaration (Prakas) No. 376* was issued ten years later, in 2009. Other relevant and detailed Declarations were subsequently developed and imposed in 2018, 2019 and 2020. Therefore, environmental protection measures have not been mainstreamed effectively into the banking and financial sector. To date, the only significant effort to this end has been the introduction of the Cambodian Sustainable Financial Principles supported and urged by the NBC and ABC in 2019. These principles are also voluntary and only serve to encourage members to apply them when possible.
- Pursuant to the *Declaration No. 021 PRK.BST* dated 03 February 2020 on the classification of environmental impact assessments for development projects; some projects require only environmental protection contracts, and the others may require initial, or full ESIA

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<sup>49</sup> Due to internal civil war among political parties, global economic crisis (1997, 2008 and 2009), the national reconciliation process with Khmer Rouge and the slow economic and social rehabilitation. Cambodia has a relatively low rate of banking intermediation, with bank loans and deposits equivalent to only 8 and 10% of GDP respectively. Source: UNCTAD & ICC (2003). *An Investment Guide to Cambodia. Opportunities and Conditions*. United Nations Conference on Trade and Development and International Chamber of Commerce. New York

reports, depending on the type of project as stated in its appendix. The appendix identifies six major project categories, including:

1. Mining, energy, and industry
2. Health
3. Water resources
4. Agriculture
5. Tourism
6. Infrastructure

Significantly, investment projects with a minimum value of USD 2 million often require only environmental protection contracts or approval from the provincial Department of Environment. Larger investments, of course, may require an initial or full ESIA, depending on the project's type, size, and development plan.

## 5.2 Challenges in Performing ESIA Obligations

Some of the challenges that banking and financial institutions face in fulfilling their ESIA obligations are:

- Cambodia is a country that needs more development and investment to turn itself into a high middle-income country by 2030. The Royal Government's policy is to encourage and motivate investors in all areas of development, including banking and finance. The intention to promote the implementation of the ESIA obligations and requirements before loan approval, as applied by the WB, IFC, or the ADB, is a valid and profoundly beneficial concept to reduce or avoid severe risks to natural resources and communities and make these investments or development projects safer. But in the context of low motivation,<sup>50</sup> high market competition, and limited awareness of the benefits of environmental and social protection among banking and financial operators and the public<sup>51</sup>, immediate fulfilment of such obligations may be an additional constraint or complication for both operators and clients wishing to seek loans from banking and financial institutions in Cambodia.
- On the other hand, why do some international or regional banks (such as the WB, IFC, ADB) do a better job than their Cambodian counterparts in mandating ESIA? We need to examine the differences between these types of banks. These international or regional banks have a different vision, mission, and mandate than local ones. Although they are for-profit banks at some level, their provision of funding also aims to contribute to poverty reduction, promotion of human rights, prevention of violence, and protecting natural resources, indigenous peoples, and women and children. These banks must carry out ESIA obligations to protect their vision, mission, and good performance. In addition to an appraisal study, some international financial institutions, such as the IFC, require the borrower to apply for a specific environmental and social management system (ESMS) within their unit or institution. This system requires additional investment in human resources, budget, and strategy to demonstrate the project owner's commitment and environmental protection obligations.
- Moreover, they are also signatories to international conventions, which require a high level of thinking and practice to protect the environment and social welfare.<sup>52</sup> This is not

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<sup>50</sup> If these banking and financial institutions are well performing their obligations and requirements for environmental and social impact assessment in their loan appraisals, what are the incentives from the Royal Government? Implementing such obligations is an additional investment of banking and financial institutions. If such an investment does not have the appropriate return from the Royal Government (in any form), the work on this obligation will not be carried out successfully. On the other hand, the law of Cambodia is not yet strictly limited because the resources (both human and budget) and the management and monitoring mechanisms for this work are still low and scarce, which will not be able to guarantee. Effectiveness and efficacy of the fulfilment of the obligations and requirements of environmental and social impact assessment in the banking and financial sector.

<sup>51</sup> Environmental and social impact assessment is a purely technical work that requires a high level of experience and understanding. There have been no previous official studies on public awareness of this work, but it can be assumed that the level of awareness and perception of this assessment work is still low among the public and public-private staff. On the other hand, environmental and social impact assessments do not seem to have been disseminated very often. Only development project owners and some direct stakeholders (such as some NGOs, appraisal consulting firms, etc.) are aware of and understand the work and process of this assessment.

<sup>52</sup> The World Bank is one of the first institutions to drive the development of the carbon market. With this role, the



the case for current Cambodian banking and financial institutions. Local banks often only fulfil obligations of corporate social responsibility programs (CSR) on a voluntary basis.

- A major contributing factor to financial institutions' failure to fulfil ESIA obligations is a lack of in-depth understanding of its benefits. Achieving environmental protection and reducing the risks that the project action plan can cause is a long-term advantage that brings many benefits, such as:
  - Improving the reputation of the project and the project owner for responsibly protecting common human resources.
  - This goodwill will help add further value and can be beneficial in seeking additional capital or credit from other national and international banking and financial institutions
  - Preventing or reducing adverse consequences for resources for the greater good.
  - Reducing risk and strengthening the protection of project benefits directly through internal and external risk management.
  - Promoting investment based on win-win principles and the achievement of sustainability, benefitting both the project and local communities.
  
- Loan sizes in Cambodia remain small for borrowers. *Large exposure* is defined as an overall gross exposure resulting from banking and financial institutions' operations with one single beneficiary, where such exposure exceeds 10% of the institution's net worth. *Declaration No. B7-016-117* of the National Bank of Cambodia, dated 22 March 2016, requires the minimum registered capital for licensed commercial banks to be USD 75 million. Based on these regulations, a single borrower in Cambodia has a limited ability to run a business or execute an investment project that will seriously degrade the quality of the environment and the community because a large exposure is capped at USD 7.5 million per borrower per bank. Such small loan sizes give banking and financial institutions the impression that their loans will not severely damage the environmental and social system.
  
- Most foreign direct investment in Cambodia comes from China in infrastructure and resource development (rubber, energy, and tourism). It has been generally observed that Chinese investments show scant regard to protecting the environment and social welfare of the host countries. For example, Chinese investments in hydropower and resort development projects have damaged natural resources, forests, and biodiversity and caused the resettlement of local populations. One example is the Golden Silver Golf Resort development project in Sihanouk province, covering 3,300 hectares in the Ream National

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Bank has contributed to being a catalyst and developing the carbon market, innovating and developing many new tools and methods, building capacity, practicing leadership in partnership with both national and international partners in determining the market and the price of carbon. Source: <https://ieg.worldbankgroup.org/blog/lessons-for-paris-agreement-carbon-markets-kyoto> retrieved on October 26 2020.

Park area, approximately 28 km from Sihanouk town.<sup>53</sup> Foreign media<sup>54</sup> and many researchers<sup>55</sup> have noted the consequences of Chinese investment projects. “*Chinese investment has had an impact on Cambodia’s foreign and domestic policies, which could lead to authoritarian rule and could lead to environmental and socio-cultural changes*”.<sup>56,57</sup> Hence, although investments from China bring about economic prosperity, concerns remain about their socio-cultural and environmental consequences in Cambodia.<sup>58</sup> The Export-Import Bank of China, one of the primary sources of these investments, has no clear policy on social and ecological protection. However, it has policies of Green Finance and Poverty Alleviation in place.<sup>59,60</sup>

- Customarily, project owners or clients who have received funding from international or regional banks (such as the ADB, the WB, or the IFC) have diligently studied and prepared ESIA's to comply with the rightful conditions of those banks. The requirements of these banks reflect the recognition of concerns about environmental-social issues and long-term sustainable development that are becoming active topics in the context of development. The provision of loans or credits in any amount enables clients or project owners to develop several large-scale projects that could pose significant social and

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<sup>53</sup> Sovinda Po & Kimkong Heng (2019). Assessing the Impacts of Chinese Investments in Cambodia: The Case of Preah Sihanoukville Province. A Working Paper on China-Cambodia Relations. ISSUES & INSIGHTS, Vol. 19, Pacific Forum

([https://www.researchgate.net/publication/333310139\\_Assessing\\_the\\_Impacts\\_of\\_Chinese\\_Investments\\_in\\_Cambodia\\_The\\_Case\\_of\\_Preah\\_Sihanoukville\\_Province\\_ISSUES\\_INSIGHTS\\_A\\_Working\\_Paper\\_on\\_China-Cambodia\\_Relations\\_Pacific\\_Forum](https://www.researchgate.net/publication/333310139_Assessing_the_Impacts_of_Chinese_Investments_in_Cambodia_The_Case_of_Preah_Sihanoukville_Province_ISSUES_INSIGHTS_A_Working_Paper_on_China-Cambodia_Relations_Pacific_Forum))

<sup>54</sup> Source: DW <https://www.dw.com/en/how-chinese-money-is-changing-cambodia/a-50130240> retrieved on October 24, 2020.

<sup>55</sup> "Weak rule of law, corruption and political risk are factors found to deter foreign direct investment (FDI) and all are characteristics of Cambodia's investment environment. Yet Chinese outward FDI has been found to contradict these general trends, as illustrated by levels of Chinese investment in Cambodia." O'NEILL, D. (2014). Playing Risk: Chinese Foreign Direct Investment in Cambodia. Contemporary Southeast Asia, 36(2), 173-205. Retrieved October 26, 2020, from <http://www.jstor.org/stable/43281288>

<sup>56</sup> Source: NIKKEI Asia <https://asia.nikkei.com/Opinion/Chinese-investment-strains-Cambodian-society> retrieved on October 26, 2020.

<sup>57</sup> "Cambodia understands that 'internationalization' of its domestic politics will not go away any time soon, especially when its evolving young democracy is becoming 'electoral currency' for some foreign politicians who often have oversimplified views over Cambodia's historical and political complexities, and are not fully aware of the values of the 'longest peace in Cambodia's modern history'" – Asia Times, published an article "Dynamism of Chinese Investment in Cambodia" on November 8, 2019. The article can be accessed through <https://asiatimes.com/2019/11/dynamism-of-chinese-investment-in-cambodia/>

<sup>58</sup> "... the case study shows to some extent that Chinese investment in the Cambodian garment sector has contributed to poverty reduction by creating employment for rural people." "... Chinese investment in the garment sector has considerably contributed to poverty reduction in Cambodia by providing employment opportunities and income generation for the rural poor." The impacts of China’s official development assistance on poverty reduction are assessed through two case studies on China funded projects in the transport sector: the Rehabilitation of National Road No 7 from Kratie to Trapeang Kriel (a border-crossing to Laos) and the Construction of the Prek Tamak Bridge in Kandal province. "Conversely, the villages can be reached more readily by development agencies which could bring social services to the areas as well as help in managing forest resources. In short, both projects have brought more livelihood options for local people." OUCH Chandarany, SAING Chanhang and PHANN Dalis (2011). Assessing China's Impact on Poverty Reduction in the Greater Mekong Sub-region: The Case of Cambodia. Working Paper Series No. 52. Cambodia Development Resource Institute, Phnom Penh, Cambodia

<sup>59</sup> The Export-Import Bank of China – Green Finance <http://english.eximbank.gov.cn/Responsibility/GreenF/>

<sup>60</sup> The Export-Import Bank of China – Targeted Poverty Alleviation <http://english.eximbank.gov.cn/Responsibility/PovertyA/>

environmental risks. It provides clients with sufficient capacity to clear, build, utilize resources, and operate their projects on a large scale, leading to the depletion of resources and disruption of livelihoods of local populations. In the volatile context, bank financing has boosted the momentum of industrialization, urbanization, agriculture, and tourism through development projects. However, those momenta have led to changes in land use and human settlements, resulting in declining water and land quality, degradation and loss of biodiversity, encroachment on forests and protected areas, increased pollution, and harmful consequences on human health. It is imperative that Cambodian banking and financial institutions begin to understand the role of loans or credits in damaging the environment and socio-cultural resources, the consequences of which may prove detrimental for their clients and development projects.

- The Cambodian Sustainable Finance Principles, launched by the ABC in 2019, reflects a certain degree of consideration for environmental and socio-cultural issues. However, the financial institutions are ultimately responsible for their implementation. They should be ready to establish and implement appropriate environmental and social risk management, especially before approving consumer loans. However, it is a voluntary principle and has no value as a form of legislation that members must compulsorily implement. The ABC only encourages and motivates its members by acknowledging their compliances and efforts through certification and recognition.
- Of the 19 main objectives of the ABC, only the 14<sup>th</sup> objective states that the association will actively implement Corporate Social Responsibility (CSR). This CSR program has no mandatory legal obligations for banks. Banks decide for themselves if they wish to implement it voluntarily. Some banks are required to implement social responsibility programs because they are members of bank alliances outside of Cambodia or have foreign sources of capital, which have policies that compel them to do so. However, most banks in Cambodia have sources of capital in countries without social responsibility obligations.
- The ABC strives to promote sustainable financial principles by careful consideration of protecting the environment, human society, and cultural heritage. The association is highly committed to prioritizing environmental and socio-cultural resource preservation through impact assessment, management and prevention of cause and effect, avoidance and mitigation of risks or adverse effects from commercial activities, and standards or transactions of customers who have received finance from the bank. These are, however, just voluntary principles without a legal requirement for members to implement. Based on the interview responses during the study, bank operators mentioned that assessing environmental risks before loan approval was limited to ensuring that they would not affect repayment capabilities. For example, the assessment focused on geographical areas to gauge if they were more prone to natural disasters like floods, storms and forest fires that could adversely affect trades or investments. These responses and similar experiences from different financial institutions indicate that some banks have not paid particular attention to their lending policies' impacts on the environment and society where their clients operate. They only lend importance to ecological concerns if these can potentially affect their clients' capacity to repay debts.

- However, some banks have put in place certain principles or policies to restrict or prohibit the approval of loans for projects contrary to their (sustainable) environmental and social principles. ACLEDA Bank's Environmental and Social Sustainability (ESS) Report shows that the bank itself is highly committed to striving for high profitability while working to protect the environment and the community.<sup>61</sup> It sets indicators for measuring and reporting activities and environmental and social impacts. ACLEDA Bank has a policy prohibiting the provision of credit or support for activities that may be unethical or harm the environment or human rights. Some policies strictly prohibit all activities related to coercion or abuse of child labour, trade in arms and ammunition, gambling, brothels, trafficking of wildlife products, and the production or trade of radioactive or highly hazardous raw materials.<sup>62</sup> The bank requires a statement of loan purpose to certify that the client's business complies with the above principles. In addition, the ACLEDA Bank supports renewable energy by providing loans to customers wishing to do business in biogas and solar power. To promote environmental and social protection, ACLEDA Bank has assigned five environmental staff fully responsible for training and retraining to coordinate environmental activities and oversee its operations. Despite such positive progress, ACLEDA has not yet required ESIA as a condition for approving their large exposures. Instead, the bank has strived to keep their environmental impacts as low as possible from their banking performance as understood through the ESS Report.
- In general, the *loan purpose* is used to determine if a project will use the credit for something that could cause environmental and social harm. The thorough scrutiny of this purpose will prevent or reduce the use of funds in directions that the bank prohibits or may cause conflict, damage, or destruction of the country's environmental and social resources and local people. As experienced, a small number of project owners misrepresent this purpose and use the capital for prohibited operations while claiming otherwise. Discussions with banking and financial institutions representatives confirm that the strengthening of loan evaluation and inspection procedures is a starting point to reduce the risks of improper loan approval. When institutions find it challenging to oversee this purpose, they can employ litigation to ensure legitimacy and accountability before the law. The loan is converted, or the loan is used contrary to the proposed loan purpose. The loan agreement should clearly define in writing how the loan amount should be used. These tasks must be done in writing in the loan agreement clearly before the loan is approved. In addition, banking and financial institutions need to strengthen controls on the utilisation of loans and apply the principle of loan withdrawal or liability before the law if the use of the loan violates the contract.
- The study results clearly show that Cambodian banks and financial institutions do not have specific policies and practices regarding the requirement for ESIA's for the projects they fund. In comparison, regional and global banks (such as the ADB, WB or IFC) mandate ESIA's for projects they identify and classify based on the level of environmental and social risks.
- The Ministry of Environment intends to disseminate and integrate the environmental and

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<sup>61</sup> [https://www.acledabank.com.kh/kh/eng/bp\\_sustainabilityreport](https://www.acledabank.com.kh/kh/eng/bp_sustainabilityreport)

<sup>62</sup> Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES).

social protection ideas by working with the National Bank and the Ministry of Economy and Finance to discuss and find possible starting points for formulating policies and guidelines available for Cambodian financial institutions. This is a necessary starting point to strengthen ties between the two sectors and achieve a win-win approach. In this sense, banking and financial institutions can further reduce the risk of loan defaults as project owners will be better prepared to respond to environmental and social impacts. At the same time, the MoE can accelerate the prevention of pollution and more effective management of natural resources.

### 5.3 Best Practices of Implementing Obligations on ESIA

Best practice refers to proper or correct implementation or practice or successful experience gained from direct performance that is compiled for sharing with other stakeholders for use as a model.<sup>63</sup> The study results and consultation with stakeholders at the meeting on November 4, 2020, confirm that the banking and financial sector in Cambodia has not yet implemented the obligations of ESIA as the conditions for approving loans. The best practice of this assessment process in the banking and financial sector was not available during this study period, as the MOE and the NBC have not yet legally mandated it for the current banking and financial institutions operating in Cambodia. The absence of this advantage is discussed and illustrated in the explanations in sections 5.2 and 5.3.

Some banks and financial institutions implement CSR obligations to enhance their business image and operations. However, this form of practice does not yet have the value and weight that can lead to reducing or managing environmental and social risks arising from bank loans, as the implementation of ESIA would. On the other hand, loan risk assessment (based on the Sustainable Financial Principles of the ABC) is the responsibility of banking and financial institutions. They collate data themselves to determine the risk level of loans before approval—for example, assessing risk to agricultural loans in the context of climate change.

Overall, there is an exiguous implementation of ESIA obligations in the Cambodian banking and financial sectors, especially as pre-conditions for loan approval. This deficiency should morph into a good starting point for advancing this concept for the better in the future.

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<sup>63</sup> Source: Rien (<https://www.rienonline.com/glossary>)

## 6. Conclusion

Promoting environmental protection and natural resource management is a multidisciplinary task requiring the active and close involvement of relevant sectors or institutions, such as banking and finance. The provision of loans is a crucial way to promote and expand development or private investment, which is often known to cause environmental and social harm. Banking and financial institutions play an important role in Cambodia, ensuring a good investment climate for sizable development or investment projects. These projects contribute to employment opportunities, income, and the developmental progress of Cambodia. Banking and financial institutions are yet to implement mandatory ESIA conditions for funding risky projects. In contrast, several international banks, such as the ADB, WB, and IFC, have developed stringent policies concerning the environment, forests, resettlement, indigenous peoples, and regional security policies, and require project owners to conform to their norms for receiving funding.

The lack of environmental and social safeguards enforcement in Cambodia's banking and financial sector is a significant concern. Credit from this sector has contributed extensively to many projects, some of which have resulted in harmful consequences for people's local resources. This challenge arises from confusion in the legal framework, especially in the banking and financial sectors, where there is no formal guidance on the impact of loan or credit operations on environmental and social resources in the region or financing from banking and financial institutions.

Notably, the Ministry of Environment and the Department of Environmental Impact Assessment have strictly enforced the obligations to manage and monitor the process and implementation of ESIA studies for any projects in the appendix to *Declaration No. 021 BRK.BST on The Classification of Environmental Impact Assessments For Development Projects (2020)* and other relevant legal practices. A compromise on ESIA obligations between the environment and banking and finance sectors has not yet been established. Although the ABC set out sustainable financial policies, these are not mandatory for its members. In addition, ACLEDA Bank has implemented the principle of environmental and social sustainability, prohibiting the approval of loans for projects that may impact the environment, society, and human rights, but this principle does not require ESIA. ACLEDA will not approve loans for projects falling under the bank's prohibited domains.

This study report shows that the environmental, banking, and financial sectors are still on varying trajectories concerning the implementation of policies and labour standards. However, some banking and financial institutions have begun to gradually integrate the practices of raising awareness and making compulsory contributions to sustainability, environment, and social responsibility. As remedial measures for the shortcomings described above, this report identifies solutions and measures needed to promote the implementation of ESIA norms for loans or credit to minimise threats to socio-cultural and ecological resources.

## 7. Key Recommendations

### Short-term recommendations:

- The MoE and the Department of Environmental Impact Assessment should initiate or continue discussions with the NBC and the ABC to find policy-forming solutions to promote the implementation of environmental and social requirements for funding development projects, as enumerated in the appendix list of *Declaration no. 021 PRK.BST dated 03 February 2020* on the Classification of Environmental Impact Assessment For Development Projects. Based on the 2019 MoU, the common policy includes the joint declaration on ESIA report requirements for the banking sector in Cambodia.
- Based on the spirit of the 2019 MoU, the MoE, NBC, and ABC should develop a more detailed and specific joint action plan to guide the implementation of environmental protection in the banking and financial sector in Cambodia, focusing on the implementation of ESIA in the operation of banking and financial services.
- As an entry point and to ease the work, the NBC should introduce a guiding policy (set as a requirement) for financial and banking institutions to apply or consider the ESIA policies and regulations (particularly the *Sub-Decree no. 72, Declaration no. 021, 092, 116, 118, 119, 120 and 376*) before their loan or credit approvals. In addition, the compliance report to these policies and regulations should be regularly submitted to the NBC for archiving, reference, and future monitoring of their performance.

### Medium-term recommendations:

- With financial and technical assistance from its partners and the Department of Environmental Impact Assessment as its general staff, the Ministry of Environment should develop additional guidelines on required procedures and operational standards for ESIA that Cambodian banks can implement. This procedure and standard can include a joint declaration (between the MOE and the NBC) on:
  - ESIA requirements in the banking sector
  - a handbook on legal standards regarding ESIA
  - procedures for monitoring and approving the ESIA report
  - the process of public participation in the ESIA study
  - the environmental observation
  - some administrative formalities (like Rapid Assessment Metric for classifying environmentally risky loan projects), which can facilitate banks to implement ESIA requirements on consumer loans.
- Banking and financial institutions need to continue strengthening and operating more thoroughly before approving loans, emphasizing the procedures for evaluating and controlling loans and monitoring loan operations later. Suppose borrowers use the loan for purposes other than those stated in the contract, for businesses prohibited by state laws, or activities with harmful social and environmental consequences. In that case, banks must immediately withdraw the loan. Borrowers must be required to conduct ESIA

or fulfil their legal obligations before the loan is renewed. In severe cases, the loan must be terminated unconditionally.

### **Long-term recommendations:**

- In the spirit of the 2019 MoU, the MoE, NBC, and ABC should jointly develop a strategic plan for educating, disseminating, and promoting accurate and up to date ESIA awareness in Cambodia's banking and financial sector. The plan must be aimed at the public, banking and financial services operators, and local communities, highlighting important issues such as:
  - a. *What is the Environmental and Social Impact Assessment?*
  - b. *The process of studying, monitoring, and approving ESIA in Cambodia*
  - c. *Legal frameworks in the environmental and banking, and financial sectors*
  - d. *The prominent roles of the MoE, the NBC, the ABC, and the project owners*
  - e. *The benefits of performing obligations on ESIA in the banking and financial sector.*
- For long-term environmental and social protection, the MOE and the NBC should necessitate lending banks to establish an *Environmental and Social Management System (ESMS)* to ensure the reduction of ecological or social damages and adequate compensation when such damage occurs. The MOE and NBC can guide lenders in establishing the ESMS through policies and implementation tools like relevant technical guidelines.

### **Questions for Discussion with Relevant Stakeholders:**

- What are the loaning policies in your institution?
- What is the large exposure for your institution, and what are the requirements for such a loan?
- What risk criteria should banks be cautious of while approving their loans to clients?
- What is the large exposure for your bank? And what are your approving criteria?
- What are the relevant environmental policies of the National Bank of Cambodia?
- What is your opinion on mainstreaming environmental concerns and ESIA in Cambodia's financial and banking sector?
- What do you think the financial and banking sectors should do first to integrate environmental concerns in their operations?
- What, in your opinion, are the biggest hurdles in starting such initiatives in the financial and banking sector in Cambodia?
- What environmental policies or ESIA do you know about in Cambodia?
- Any last comments?



