

October, 2008

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Cambodia still suffers from a legacy of 20 years of civil unrest which occurred between 1970 and 1990, when the social and economic infrastructure of the country was virtually destroyed by Khmer Rouge.

Following the Paris Peace Accords of 1991, microfinance was an area where donors achieved remarkable success in forming close partnerships with private sectors, civil society, as well as the government. In the 1990s, Cambodia's banking sector went from a mono-banking to a two-tier banking system that separated the functions of the central bank from commercial banks. The Royal Government of Cambodia (RGC) introduced banking regulations in 1999 and a bank-restructuring program in 2000. As a result, many banks were liquidated (32 institutions were consolidated into 19). Today, 17 banks remain in operation, including one state-owned commercial bank, three foreign bank branches, ten local banks, and three specialized banks, one of which is state owned.

Microfinance, which is included in the National Strategic Development Plan 2006-2010, has evolved from a series of small, isolated projects into what is arguable the most sophisticated segment of the national financial services sector. To date, 17 registered MFIs serve about 767,015 borrowers with outstanding loans of USD\$ 257 million. The sector has expanded at 30% per year and is contributing to poverty alleviation. Deposit services have also risen, even if they lag significantly behind credit services.¹

Cambodia is one of the poorest countries in Southeast Asia: 35% of its 14.2 million citizens live below the national poverty line (it ranked 130 out of 177 in the 2008 Human Development Index).² The rudimentary banking system cannot begin to address demand from the poor for microfinance to smooth consumption, build assets, and develop microenterprises. Furthermore, it does not meet the demand from the middle and upper segments of the rural markets for financing commercial cultivation, agricultural trading, and rural and agriculture-related enterprises. Nearly 40% of the people have no access to formal banking services. Only 6% of total banking sector advances are for agriculture or related activities, primarily short-term dollar-denominated loans. The estimated demand for rural finance is USD\$ 120-130 million per annum, of which one third is for microcredit ranging from USD\$ 50 to USD\$ 300. This is only fractionally met from institutional sources. Reliable saving facilities are generally not available in rural areas or to the poor. Currently, around 90 NGOs supported by funding agencies such as Kreditanstalt für

Wiederaufbau (KfW), Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ), United Nations Children's Fund (UNICEF), International Fund for Agricultural Development (IFAD), United States Agency for International Development (USAID) provide microfinance to nearly 420,000 poor households, or 15% of the total, with most of the borrowers being women. In 2000, the estimated aggregate outstanding microcredit was USD\$ 30 million, and savings mobilized was USD\$ 1.4 million. Service delivery is through "village banks" consisting of 100-200 members and managed by a village credit committee. Members are organized into groups and are provided with some basic training; they are given individual credit with group liability. Loans varying from USD\$ 20 to USD\$ 300 are provided for 3-12 months with equated installments and incentives for timely repayment. Interest rates on loans range from 3 to 5% per month. Repayment rates are 80-95%. The balance of microfinance is supplied by informal sources, either based on reciprocity and social obligations or from moneylenders and suppliers.³

THE DEVELOPMENT OF MICROFINANCE SECTOR

The start-up phase began in the early 1990s, when multilateral and bilateral donors and international NGOs began financing projects to deliver credit to poor micro-entrepreneurs. At that time there was a vacuum of functioning institutions and government oversight of the financial sector. International NGOs such as the Group de Recherche et d'Etudes Technologiques (GRET), Catholic Relief Services (CRS), and World Vision, together with some early donors such as United Nation Children's Fund (UNICEF), International Labour Organization (ILO), United Nation Development Programme (UNDP), Agence Française de Développement (AFD) and United States Agency for International Development (USAID), played a significant role in launching the first microfinance programs in the country. Most of these early initiatives were financed as credit components within integrated rural development programs. They utilized a wide range of microcredit delivery methodologies, from individual loans to solidarity groups, village banks, and self-help groups.

From 1995 to 1999 microfinance underwent a phase of institutionalization, and achieving financial sustainability of microfinance providers became the primary objective. The supporters of microfinance in Cambodia started meeting regularly during this time to share information, align objectives, and define a common vision for the sector. NGOs formed their own forum while the Cambodia Committee for Rural Development (CCRD), a government body established in 1995 to formulate a strategy for rural credit development, strengthen management and manage donor funding, providing also a platform for broader discussion.

In 1997, the National Bank of Cambodia set up the Supervision Office of Decentralized Banking System Bureau. The office was then split in 2000 into the Specialized Bank and MFIs Supervision Office - for coordination, supervision and regulation of the sector - and the Project of Support to the Microfinance Sector (PASMF), for capacity building.

In 1998, the government also created the Rural Development Bank (RDB), as the main promoter of rural finance, and a state-owned apex institution, established to promote microfinance in Cambodia.

The International Monetary Fund (IMF) and the Asia Development Bank (ADB) supported the government in formulating a comprehensive macroeconomic and structural reform program, including a modernization of the financial system modernization and corresponding legislation. The Law on Banking and Financial Institutions of 1999 (Royal Kram NS/RKM/1199 13, LBFI) created a legal framework for a broad range of financial service companies, with appropriate mechanisms for licensing, regulation, and supervision, in order to increase confidence in the financial sector. With these changes, the emerging microfinance community encouraged the CCRD to allow the National Bank of Cambodia (NBC) to assume responsibility for regulating and supervising microfinance.

The success of NGOs in providing credit to the poor and largely rural population encouraged the NBC to issue regulations which establishing a special license for MFIs and a registry for NGOs. The issuance of new *prakas* (implementing decrees) in 2000 and 2002 marked a move towards the commercialization of microfinance and its integration into the formal financial system of Cambodia.

In 1999, under the LBFI, the Government of Cambodia adopted a two-tier system for supervising microfinance. A *prakas* on microfinance regulation was introduced in 2000 and implemented by the NBC. Under this regulation, MFIs with a portfolio over R100 million (tier 1) must be registered with NBC, while MFIs with a portfolio over R1 billion must be licensed, as limited liability company or as a cooperative. Only licensed MFIs and banks are eligible to access the USD\$ 20 million ADB credit line channeled through RDB and established in 2001.

In 2005, the Consultative Group to Assist the Poor (CGAP, 2005) has highlighted the most pressing challenges for the successful growth of microfinance in Cambodia in its Country-Level Effectiveness and Accountability Review. In particular, the need for improvements of the regulatory framework and information sharing between MFIs were addressed.

In October 2008 the Phnom Penh Post reported regulators plan first credit bureau to link

Cambodian financial institutions into a national financial database. The decision to build such a market infrastructure in order to allow institutions to access personal credit risk and avoid client's over-indebtedness has been brought on by the global credit crisis, which effects would result in a 20% reduction in foreign investments fulfillment of customer credit needs.⁴ "Authorities hope the new system will bring the country's fast-growing borrowing into the regulatory fold and protect the market from runaway debt."⁵ It is estimated that Cambodian microfinance sector needs about USD\$ 20 million per year.⁶

REGULATION

The LBFI and the *prakas* for implementation, enacted in early 2000, recognize three categories of banking institutions:

- Commercial banks, which require a minimum registered capital of USD\$ 13 million and can carry out all banking activities.
- Specialized banks, which require a minimum registered capital of R10 billion (USD\$ 2.5 million) and can carry out a limited number of banking activities, as specified in the terms of their license.
- MFIs, which require a minimum registered capital of R250 million (USD\$ 62,500).

Registration or licensing by the NBC of microfinance providers is compulsory when operators meet one or more of the following conditions:

Table 1: Circumstances for Mandatory Registration or Licensing

Financial products	Registration	Licensing
Credit	<i>Loan portfolio outstanding</i> Riel 100 million (US\$25,000) or more	<i>Loan portfolio outstanding</i> Riel 1 billion (US\$250,000) or 10,000 borrowers or more
Savings	<i>Voluntary savings mobilized</i> Riel 1 million (US\$250) or more or 100 depositors or more	<i>Voluntary savings mobilized</i> Riel 100 million (US\$25,000) or more or 1,000 depositors or more

Therefore, the NBC basically provides two main alternatives for microfinance operators in Cambodia: licensing for the 'medium-sized' microfinance providers or registration for the 'small' microfinance providers.

Among others, key prudential regulations for MFIs include the following: capital guarantee deposit of 5% of capital; capital adequacy ratio of 20%; reserve requirement

of minimum 5% of voluntary deposits; liquidity ratio with liquid assets of at least 25% of voluntary savings; aggregate loan commitment to any one client cannot exceed 10% of net worth.

According to the legal framework, microfinance is defined as: “the delivery of financial services such as loans and deposits, to the poor and low-income households, and to microenterprises.” All microfinance operators, whether licensed or registered, are excluded from a range of financial sector activities including leasing, derivatives, gold and commodities dealing, the provision of cheque facilities and swap or forward dealing in foreign currencies. Registered and licensed operators must report to the NBC. In addition, licensed MFIs must pay taxes when they are established as limited liability companies.⁷

The vision of integrating microfinance into the regulated financial system arose from consultations between the government, the NBC, and leading MFIs. In October 2000, the Association of Cambodian Local Economic Development (ACLEDA, currently Cambodia’s third-largest bank, with a national network of 176 branches, mainly in the rural areas and the largest MFI, the only one to offer voluntary deposit services) transformed from an NGO into a specialized microfinance bank with the support of its founding donors and new institutional investors. The bank received in 2008 a B+/B credit rating from Standard and Poor’s. ACLEDA bank’s transformation provided an important precedent for other financial providers. During this phase, socially responsible investors and development finance institutions replaced the donors that had financed the start-up and institutionalization of NGOs and, until this stage, had served as their primary funding and advisory partners. Nine of the leading NGOs subsequently transformed into licensed institutions with the assistance of their original donors and new investors (which provided capital and governance).

As of December 2007, the banking system is composed of:

- 16 commercial banks, of which 13 are locally incorporated and three are foreign branch banks;
- 6 specialized banks, of which one is state-owned and five are private-owned
- 17 licensed MFIs and 25 registered micro operators operating in rural areas

COMMERCIAL BANKS

There were 30 commercial banks until 2000 including the RDB. Those banks are under the supervision of the NBC. The banking sector contained many small banks, which

were operating marginally. Most the banks were not financially viable.

The activities of commercial banks remain concentrated in the city and focused on large transactions of a commercial nature, real estate and multinational corporations. Poor people living in rural areas do not have access to loans or saving facilities with commercial banks. The commercial banks have neither resources nor the possibility to expand their limited range of rural services because microfinance operations especially rural microfinance requires high cost and is hardly profitable.

After the adoption of the LBFI, the NBC launched a banking system restructuring program by requiring all banks to apply for re-licensing. As a result, 16 commercial banks were successively eliminated from the banking system and there are now new banks and MFIs coming into the system. The banking system is now developing its network to provide financial services all over country.

NGOS OPERATING IN MICROFINANCE

There are about 90 NGOs supplying credit in the rural areas, seven of which play significant role. International NGOs established local NGOs in order to establish an organization on a continual basis. Many local NGOs are supported by international NGOs that provide management guidance and financial support for institutional building and credit for revolving funds.

At the end of 2000, cumulatively NGOs had total outstanding loan portfolio of USD\$ 29 million and total saving of USD\$ 1.5 million. The total number of borrowers was 147,000 in 20 towns and provinces, representing 18% of the total number of the Cambodian population. Female borrowers represented 80% of total loans. Most NGOs provide loans to group members of the same occupation or type of business. In these cases, there are few opportunities for loan diversification. Loans are usually provided on a six-month cycle basis. Most of the smaller NGO credit operators have compulsory saving requirements which involve members controlling group savings and using these saving to lend among themselves.

TRADERS, MONEYLENDERS, RELATIVES AND FRIENDS

Similarly to loans from formal and non-formal institutions, loans from informal sources are commonly used for agricultural production and investment in business. They are also important for supplying a temporary family income in the event of sickness and for other purposes.

Interest rates on loans from informal sources are extremely variable, ranging from interest-free on many loans from relatives and friends, to 20% per month and higher than those from traders and moneylenders. Despite high interest rates, borrowers continue to use informal services for a variety of reasons, including ease of the application procedure, flexibility in repayments, personal relationships, and a lack of alternatives to access to formal loans.

MICROFINANCE INSTITUTIONS (MFIs)

In 2000, NBC started to issue and revise regulations in order to transform NGOs into registered and licensed MFIs according to their scope of operations. After receiving license and registration certificates, institutions are regulated and supervised by NBC. Since 2000, some NGOs have been licensed and some others have been registered. By the end of December 2007, there were 17 licensed MFIs and 25 MFIs registered as rural credit operators (NBC Source). Many of these institutions were transformed from NGOs, while others were local private companies.

MFIs transformed from NGOs kept their culture and still used the methodology of lending in the form of solidarity groups. Lending to individuals requires collateral when there is no trustworthy guarantor. For local private MFIs, the majority of loans have been lent to individual clients with the required collateral. The microfinance industry is expanding rapidly, providing the link between the formal financial sector to rural households and micro-enterprises. The number of active borrowers who had access to rural household credits, micro-business loans and small-business loans reached a total of more than 624,000 clients (4.3% of the total population) at the end of 2007, with the potential for further growth. Microfinance lending has also grown from USD\$ 92.2 million in 2006 to USD\$ 160.1 million in 2007, with reported non-performing loans below 5 percent. Voluntary saving remains very small and access to local finance by MFIs has been very limited. With technical assistance from ADB, NBC issued a *prakas* in December 2007 setting out the criteria for MFIs that are eligible to mobilize voluntary savings. A public campaign to promote MFI savings has commenced.

In 1999, the LBFI established a minimum capital requirement for commercial banks, specialized banks and MFIs. Organizations exceeding the specified number of clients, portfolio or voluntary savings are required to license as an MFI. The law provides for two structures for the MFI; the limited liability company or the cooperative; laws governing cooperatives have yet to be introduced, and as such, a suitable legal form for credit unions has yet to be introduced. MFIs pay company tax and report monthly to the NBC, showing their compliance with the ratios and regulations. In particular, capital

adequacy ratio of 20%, minimum liquidity requirement of 100% and loan loss provisioning.

Based on this Law, the NBC has released some regulations related to microfinance sector as follow:

- 1 *Prakas* on the Licensing of MFIs
- 2 *Prakas* on the Calculation of Interest Rate on MFIs
- 3 *Prakas* on the Maintenance of Reserve Requirement for MFIs
- 4 *Prakas* on Reporting requirement for registered NGOs and MFIs
- 5 *Prakas* on Liquidity Ratio Applicable to Licensed MFIs
- 6 *Prakas* on Registration and Licensing of MFIs
- 7 *Prakas* on Loan Classification and Provisioning Applicable to Specialized Banks for Rural Credit and Licensed MFIs
- 8 *Prakas* on Adoption and Implementation of Chart of Accounts for MFIs.

The main provisions of these regulations are:

- Criteria for licensing and registration: the identification of permanent shareholding, in particular the influential shareholders holding 20% or more of the capital
- Requirement of a license: NGOs having loan outstanding of KHR 1,000 million or more on 1,000 borrowers or more
- Minimum paid-up capital: KHR 250 million, compared to KHR 50 billion for commercial banks
- Liquidity ratio: 100% compared to 50% for commercial banks
- Solvency ratio: 20% compared to 15% for commercial banks
- Capital guarantee: 5% compared to 10% for commercial banks
- Reserve requirement: 5% compared to 8% for commercial banks
- Calculation of interest rate shall be based on the remaining balance of credit
- Reporting requirement: monthly for licensed MFIs and quarterly for registered NGOs
- Reporting: Asset and liability statement, profit and loss statement, statement of deposit and loan classified currency and by types, loan classification, and branch network
- Introduction of uniform chart of accounts of NBC into the system (MIS)

- Annual license fee: KHR 1 million for each MFIs with no fee for branch, the purpose of promoting the expansion of branch network to reach poor people in remote rural areas
- No fee for registered NGOs

Table 2: Financial Requirements for Cambodian MFIs v. Commercial Banks

	MFIs	Commercial Banks
Minimum paid-up capital	KHR 250 million	KHR 50 billion
Liquidity ratio	100%	50%
Solvency ratio	20%	15%
Capital guarantee	5%	10%
Reserve Requirement	5%	8%

Table 2 shows the different consideration for MFIs and commercial banks regarding the main financial requirements (liquidity ratio, solvency ratio, capital guarantee and reserve requirement).

POLICY TO STRENGTHEN MICROFINANCE SECTOR

In 1999-2000, the government and the Asian Development Bank (ADB) worked together to develop a long-term strategy to develop the financial sector in Cambodia. As a result, the Financial Sector Development Plan (FSDP) for 2001-2010 (former FSB 2001-10) was promulgated by the government, and since that time has served to guide the efforts of the government, stakeholders in Cambodia's financial sector, and the donor community in supporting the development of the financial sector in Cambodia. To develop a sound market-based financial system to support resource mobilization and broad-based sustainable economic growth, the FSDP 2001-10 specified ten principles as the government's long-term strategy for financial sector development.

In 1998, the RDB was established by the Royal Government of Cambodia as a specialized bank under guardianship of MEF and under technical supervision of NBC. RDB's main duty as wholesale bank is to provide financing and refinancing those licensed commercial and specialized banks and to MFIs whose activities support rural economy.

The government also established the CCRD in order to:

- prepare and approve the strategic framework and national policy in the microfinance sector for rural development;

- promote and monitor the implementation of strategy and national policy in the microfinance sector with high efficiency;
- coordinate the use and implementation of credit projects for development in the microfinance sector for organizations that received financing from government, national and international financial institutions, donor countries and other credit resources in order to ensure that the use of such credit in line with strategy and national policy which determinates;
- arrange programs and action plans in order to develop the microfinance sector, including the mobilization of overseas donations in the form of bilateral and multi-lateral funds for rural credit demand, and to promote national financial institutions for supporting to the development of rural credit in Cambodia;
- participate in capacity-building of microfinance institutions and practitioners through the arrangement of national and international seminars and seeking donations to strengthen this sector.

NOTES

¹ UNDP (2008).

² The Phnom Penh Post (2008), *Inflation tops 25pc in first half of year, growth to slow*, 25 August; and, *First credit bureau slated to open within 18 months*, 27 October. On savings, see Pickens (2004), CGAP (2005) at 6, and ADB (2008).

³ ADB (2001).

⁴ The Phnom Penh Post (2008), *MFIs fear cash drought*, 8 October.

⁵ The Phnom Penh Post (2008), *First credit bureau slated to open within 18 months*.

⁶ The Phnom Penh Post (2008), *MFIs fear cash drought*.

⁷ From BWTP (2005).

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