

## Strengthening the Financial Sector in Cambodia



*The financial sector is widely recognized as key for economic development. By mobilizing resources and channeling them into productive investments, the finance industry provides businesses with the capital necessary to expand, create jobs, develop human resources and in other ways contribute to economic growth and poverty reduction. Recognizing the vital role of the finance industry, the Royal Government of Cambodia has initiated a number of important reforms in the sector since the 1990s. With support from development partners and active participation of the private sector, government reform efforts have greatly increased confidence in the financial sector and, as a consequence, lending has increased tremendously from **US\$ 280 million** in 2002 to nearly **US\$ 1.6 billion** in 2007.<sup>1</sup>*

Although growth in lending over such a short period is impressive, total lending is still relatively small given the size of the country's economy. At roughly 18% of GDP,<sup>2</sup> the ratio of total lending to GDP is still far below that of neighboring countries and this means that the private sector still faces difficulties in accessing credit.

In order to provide private companies with the financing they need to thrive and achieve their potential, the government needs to provide a good enabling environment so that financial institutions can offer more types of financing than just loans secured by land and buildings. In this issue of the *Bulletin*, we discuss the regulations needed to introduce or improve on three important finance industry tools: *Credit Information*, *Secured Transactions* and *Leasing*.

### Better credit information through a private credit bureau would help improve access to finance for Cambodian SMEs

The provision of financing for the private sector, and especially for individuals and small businesses, is constrained by the lack of credit information available to lenders. Lack of information greatly increases risk and uncertainty for

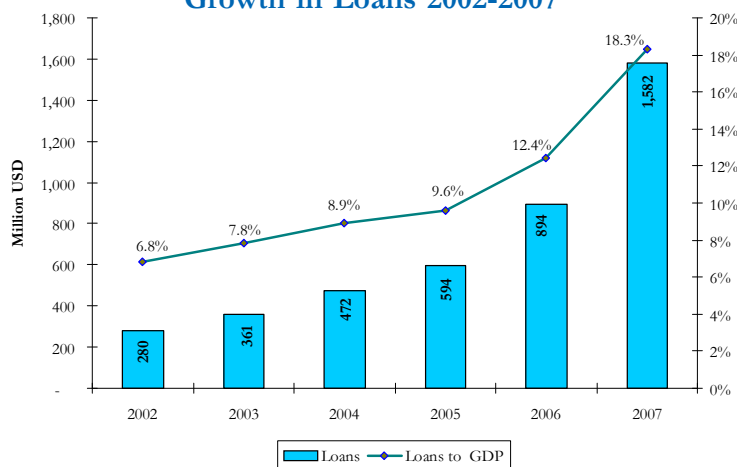


The *Business Issue Bulletin* provides those interested in business issues with a short summary and analysis of a particular topic affecting the business environment in Cambodia. Also included are opinions on the topic from a number of relevant stakeholders.

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The statements and opinions presented here are only meant to provide additional reference material and do not reflect the official opinion of IFC.

Growth in Loans 2002-2007



<sup>1</sup> National Bank of Cambodia.

<sup>2</sup> Calculations based on data from the National Bank of Cambodia and the National Institute of Statistics.

lenders, with the result that unless borrowers have land and building worth far more than the value of the proposed loan, banks are unwilling to lend. The Asian Development Bank (ADB), in its SME development program, identified lack of credit information as a serious deficiency in Cambodia, and one of the chief reasons why both SMEs and individuals find it so difficult to get the financing they need.

To improve the availability of credit information, the National Bank of Cambodia (NBC), with technical assistance from ADB, began working on a pilot Credit Information System (CIS) in 2004 in partnership with the Association of Banks in Cambodia, and participating banks. The CIS, which became operational in 2006, collects and shares among members only 'negative' credit information on defaulting borrowers.

However, after a few years of operation at NBC, the finance industry has made limited use of the CIS because financial institutions need more than just 'negative' information in order to comprehensively assess would-be borrowers. It would be more useful if the system provided positive information including: the outstanding loan amounts of potential borrowers; whether they are repaying these loans on time; and whether they are making other payments on time, such as monthly credit card, telephone, and electricity bills. With such information available, lenders would not only be able to screen out individuals and businesses with bad debts, but would also be able to lend on better terms to borrowers who have a good credit history.

In order to gather and provide financial institutions with both 'positive' and 'negative' information on borrowers, international experience suggests that a private credit bureau is a better and more sustainable mechanism. Private credit bureaus are better able to collect, maintain and share both positive and negative information and can also offer value-added services such as processing of credit applications and the provision of credit scoring tools. Thus, the development of the necessary legal framework should be given priority in order to support the establishment of a private credit bureau in Cambodia, as demand for credit information now exceeds what the CIS was set up to provide.

*The Credit Information System (CIS) has been piloted since 2006. However, improvements are needed to the CIS so that it can effectively respond to the needs of clients. Factors that contribute to the reduced effectiveness of the current system include: i) voluntary rather than compulsory membership; ii) sharing only negative credit information which is of limited usefulness to banks; and iii) delays and other difficulties in entering information that discourage some members from doing so.*

*NBC is currently discussing the possibility of the establishment of a private credit bureau. We are working with IFC MPDF to conduct a survey of micro-finance institutions and utility companies to determine their interest in using a credit bureau and their ability to contribute credit information. Following the survey, NBC will be better able to prepare a plan for establishing the credit bureau. For now, it is too early to say when we will have a private credit bureau. However, it is the policy of NBC to support its establishment.*

**H.E. Phan Ho, Secretary General,  
Cambodia Financial Intelligence Unit, NBC**

*To make this system work, more than just banks are required to participate, and it would be of great benefit if government institutions of the likes of Electricite Du Cambodge and Cambodian telecom companies were also sharing information in the system.*

**Mr. Gary Runciman,  
Head of Business Financial Services,  
ANZ Royal Bank**

*There is need for a private credit bureau in Cambodia. Although individuals and businesses increasingly need financing, financial institutions find it difficult to meet their demand due to the lack of reliable credit information to help banks make credit decisions. A private credit bureau would be very helpful in developing robust credit histories, based on a wider range of information. However, before a private credit bureau can be established, some changes need to be made to the legal framework such as an amendment to the Banking Law, which currently does not allow financial institutions to disclose client information. This law needs to clarify what information can and cannot be disclosed.*

**Mr. Hout Ieng Tong, General Manager,  
Hattha Kasekar Limited (HKL)  
and Chairman of the Cambodia Microfinance  
Association (CMA)**

*A Credit Information System is only beneficial if everyone uses it and shares information. Currently, few financial institutions participate, which reduces the usefulness of the system. In addition, the system is cumbersome so it takes a lot of our time to register information. More system support is needed if problems arise in data entry and access. Another problem is that the system requires a client identification number or passport number, which is not always available in Cambodia. In many cases, our clients are located in rural areas and do not have such identification or even a family book. Additional methods are needed to uniquely identify each borrower.*

**Mr. In Siphann, Senior Vice President and  
Head of Credit Division, ACLEDA Bank Plc.**

## **Need for effective enforcement of the Secured Transactions Law**

As a rule, banks in Cambodia will not lend unless the borrower has fixed collateral, i.e. land and buildings, and these should be located in Phnom Penh or a major provincial town. Also, banks will not lend more than 30% to 50% of the total value of collateral.

Movable and intangible assets such as motor vehicles, machinery, receivables and inventory are not accepted as collateral because banks are afraid that they will not be able to take possession of such property if the borrower fails to repay the loan. This limits the ability of businesses that lack fixed collateral to obtain the financing needed for business expansion. This, in turn, has negative consequences for the economy as a whole because it constrains businesses from growing and contributing more to economic development.

In recognition of the need for businesses and individuals to borrow against moveable and intangible assets, the government has been working on a legal framework that will assure banks of the right to seize assets should a borrower fail to repay.

The Secured Transactions Law was passed in May 2007, with the support from ADB, to provide the legal grounds for using movable and intangible assets as collateral. The law is comprehensive and provides rules that allow a creditor to seize assets should the debtor fail to fulfill his or her loan obligations. The law also defines a broad scope of movable and intangible assets that can be used as security, and it provides clear rules that give priority to secured creditors, and a low-cost and simple process of registering security interests. The Ministry of Commerce, as overseeing authority, has developed an Internet-based filing system with support from ADB. In addition to allowing a financial institution to register the moveable and intangible assets it has accepted as collateral for a loan, it also allows the financial institution to search the registry for prior claims on these assets. In cases where a borrower defaults and there is a dispute among creditors, the registry will be used to determine which creditor has priority in seizing the collateral.

Financial institutions, as well as borrowers, see adoption of the Secured Transactions Law as an important step in improving access to finance in Cambodia. If implemented effectively, businesses as well as individuals that lack land and buildings but have valuable moveable and intangible assets should find it easier and less expensive to borrow.

However, effective implementation of the legal framework for secured transactions and winning the confidence of the banking community has yet to take place. A year after the law was enacted, little lending based on movable and intangible assets is taking place. According to banks interviewed for this Bulletin, there are two main concerns:

- *The Secured Transactions Law and the Civil Code are in conflict over repossession:* Although the Secured Transactions Law gives financial institutions the right to seize collateral without going to court if a borrower defaults, under the Civil Code, finan-

cial institutions must go through the court process before assets can be seized and liquidated.

- *Financial institutions have limited confidence in the online registry for secured transactions:* Due to a lack of familiarity with the registry, financial institutions still prefer to register assets on paper and have this stamped by the overseeing authority to prove registration of the assets.

More efforts are needed from government in order to ensure that financial institutions have confidence in implementation of the Secured Transactions Law and that movable and intangible collateral can be easily searched and properly registered using the online registry.

*The Secured Transactions Law is very useful and its registration system is fantastic. However, the conflict between the Secured Transactions Law and the Civil Code is a concern. In a deteriorating relationship with a borrower, financiers need to act swiftly to protect their position. Once this conflict in the laws has been resolved, and we are able to receive properly audited financial information, it is highly likely that we will provide financing with collateral other than land and buildings.*

**Mr. Gary Runciman,  
Head of Business Financial Services,  
ANZ Royal Bank**

*Resolving the conflict between the Law on Secured Transactions and the Civil Code is needed, along with an effort to increase public confidence in the filing system. Transparency in the registration process as well as in its management should not be seen as a problem.*

**Mr. In Siphann, Senior Vice President and  
Head of Credit Division, ACLEDA Bank Plc.**

*Since the Secured Transactions Law was adopted, there have been more than 100 security pledges filed in the registry. Therefore, I would say that the secured transactions framework is succeeding. Slow growth in secured transactions and the use of the Internet-based registry is not surprising as this is a completely new concept in Cambodia, and it is still not well understood by the finance industry. We fully recognize this shortcoming and are working to disseminate information on this law, especially at the provincial level.*

*Regarding conflict with the Civil Code, I think this is not a big problem. The law is clear on which cases need to go through the normal court process and which do not. The problem is only with the implementation procedures, and we need a sub-decree to clarify this. Currently, ADB is helping us to prepare this sub-decree. In response to limited public confidence in using the new internet filing system, we are now flexible. Financial institutions can print out the registration document from the system and we will stamp it for those who request written verification.*

**H.E. Mao Thora, Secretary of State,  
Ministry of Commerce**



## Leasing could significantly improve access to finance for Cambodian SMEs

Leasing refers to paying for the use of equipment such as vehicles or machinery without owning it. This enables businesses to improve their operations without having to borrow money for large capital expenditures. Instead a bank or leasing company owns the equipment and leases it to the user. This is particularly helpful for SMEs who lack the necessary collateral to get financing. Thus, leasing can help speed-up the growth of businesses, and contribute to Cambodia's economic development.

The Law on Banking and Financial Institutions promulgated in 1999, allows Cambodian banks to offer leasing, however, the provisions in the law are quite general, with no clear legal framework for how leasing should be managed. International experience shows that leasing is only effective when there is a comprehensive legal framework governing leasing operations. A leasing law and related regulations should specify how a contract is to be enforced if a lessee fails to pay and how leasing arrangements are to be taxed. Currently, there is no clear legal framework to ensure that a lessor can quickly repossess equipment if a lessee defaults. Without this, most banks are reluctant to finance leasing arrangements.

Recognizing the importance of and potential for leasing, the government has made leasing a priority in its Financial Sector Development Strategy for 2006-2015. A leasing law and related regulations has been developed but must be approved by the Council of Ministers before the law can be submitted to the National Assembly.

It is the prevailing perception in Cambodia that the court system is ineffective. It is therefore imperative that an effective enforcement mechanism be put in place before leasing is widely used as a financial product<sup>3</sup>. The draft Leasing Law contains provisions that will enable fast, efficient, and effective repossession of leased assets without resorting to court procedures. These provisions should help to promote leasing in Cambodia. Tax provisions to ensure that leasing is not disadvantaged when compared to bank lending, are also needed, especially with regard to value-added tax, profit tax and withholding tax.

*Commercial banks regulated by the National Bank of Cambodia have the ability to provide leasing facilities to customers under the existing Banking Act. However, concerns continue about taxation of leases, and this inhibits customers who would like to lease rather than buy their assets.*

**Mr. Gary Runciman,**  
**Head of Business Financial Services, ANZ**  
**Royal Bank**

## Conclusion

Since commercial banking resumed in Cambodia in the 1990s, after decades of war and isolation, the government has continuously improved the regulations covering the financial sector. However, for the industry to achieve its potential in helping smaller enterprises to expand and contribute more to economic development, further improvements are needed.

Comprehensive credit information is needed to encourage greater lending. This will not only reduce financial institutions' risks in lending, but borrowers with a good repayment history should benefit by having better access to finance and on more favorable terms. Enabling laws and regulations required for the operation of a private credit bureau need to given high priority by the government.

With regard to secured transactions, although the law is in place, a perceived conflict exists with the Civil Code that needs to be resolved to ensure that financial institutions with pledges of moveable and intangible assets as collateral can quickly repossess them if a borrower defaults. In addition, the Internet-based registry should be better promoted so that lenders and other stakeholders make more use of it.

To enable leasing to achieve its full potential to provide businesses with new technology, vehicles and other equipment, a comprehensive legal framework is necessary to ensure favorable taxation of leasing transactions and enable lessors to repossess leased assets quickly if a lessee fails to fulfill his or her obligations.

With a comprehensive private credit bureau, improved implementation of the Secured Transactions Law, and an effective leasing law and regulations, businesses in Cambodia will have better access to finance. This will allow SMEs to expand their operations and will contribute to economic growth and poverty reduction.

<sup>3</sup> Ministry of Industry, Mines and Energy, Cambodia Small and Medium Enterprise Development Program, *Final Report for TA No. 4476-CAM: Cambodia SME Development Program*, August 2006.