

Green Financing Policy Implementation in Cambodia

POLICY BRIEF

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1. Introduction

The **Cambodia Sustainable Development Goal (CSDG)** framework was adopted in 2018 with the commitment to implement the **United Nations 2030 Agenda for Sustainable Development**. Two of the five pillars of the Agenda, *people* and *planet*, include environmental, social and governance (ESG) principles and the promotion of sustainable economic growth. To achieve this, the Royal Government of Cambodia (RGC) has taken steps to include green financing in its sustainable growth strategies. For example, the Ministry of Environment (MoE) signed an MoU with the National Bank of Cambodia (NBC) to implement green financing in Cambodia. In 2019, the Association of Banks in Cambodia (ABC) published the "**Cambodian Sustainable Finance Principles**", through which Cambodian banks commit "*to priorities the environment, protect our people and preserve our cultural heritage by actively assessing, managing, mitigating, offsetting or avoiding potential risks or negative impacts arising from our clients' business activities, standards or practices*". The NBC appreciates and stands witness to the initiative while encouraging banks in Cambodia to consider these principles when offering loans to businesses. NBC will develop a green financing policy based on the ASEAN taxonomy, published in November 2021.

The finance and banking sectors have been considered to play an essential role in promoting sustainable economic growth. The proliferation of a large number of banking and financial institutions by 2019 in Cambodia is a clear testament to the growth of economic activity in the country, including a rise in investment or development projects, which matches the aims of the Development Policies of the RGC . The

damage to the environment and resources caused by unsustainable development projects can often be indirectly and, in some cases, directly linked to financial institutions' credit policies and lending practices. This issue becomes more acutely evident if these institutions do not require their clients to conduct environmental and social impact assessments as part of the loan usage policies for development projects. A recent study by Fair Finance Cambodia (FFC) on the Social and Ecological Impact Assessment (ESIA) compliance in the banking sector in Cambodia proposed clear policy options for both the banking sector and the MoE.

New non-banking sector actors that facilitate sustainable/responsible financial markets have emerged in many different forms in response to recent macroeconomic policies and socio-economic development and growth in Cambodia. Among them, the Securities and Exchange Regulator in Cambodia (SERC) has played a crucial role as a regulatory body on securities and exchange transactions in Cambodia, which is essential for promoting ESG frameworks and integrating the United Nations Guiding Principles on Business and Human Rights (UNGPs) criteria. To understand the implementation of ESG policies and regulations by SERC, FFC, through the NGO Forum on Cambodia, undertook a study to examine if SERC's policies and regulations have incorporated ESG principles in regulation and enforcement, focusing primarily on green financing.

2. Objectives of the Study:

- To identify green financing regulations and requirements that SERC regulates (with particular emphasis on ESG, environmental and climate change, with UNGP criteria and

Fair Finance Guide International Methodology , including but not limited to other ESG principles such as the Equator Principles and the Cambodia Sustainable Banking Principles where possible).

- To examine the progress and challenges in enforcing these regulatory processes and the trends of enforcing green financing regulations by SERC and for SERC's market participants' policies.
- To develop a green financing policy brief outlining alternative options for implementing better green financing policies in Cambodia.
- To present green financing policy recommendations to facilitate FFC to engage a wide range of stakeholders to develop and enforce ESG principles. These include SERC, MEF , MoE , and multi-stakeholder bodies such as the ADB , WB , AIIB , UNFCCC , NBC , ABC and MFI .

3. Policies, Initiatives, and Regulations Related to Green Financing

For the environmental sector, there exist vital legislation such as (1) *1996 Law on Natural Resources Management and Environmental Protection*, (2) *1999 Sub-Decree no. 72 on Environmental Impact Assessment Process*, (3) *2009 Prokas no. 376 on General Guideline for Preparing the Initial Environmental Impact Assessment*, (4) *2020 Prokas no. 021 on Classification of Development Projects for Environmental Impact Assessment*, and (5) other relevant sub-decrees¹ on pollution control and Prakas on the use of term references for some development projects.²

For environmental protection policies in the context of social and ecological impact assessments, Cambodia's legal framework has not yet given attention to the promotion of ecological and social issues and natural resource protection within the banking and finance sectors. Existing legislation has only aimed at sharpening technical work and improving the efficiency of management of environmental and social

impact assessments, with specific guidelines from the Ministry of Environment. There is no legal basis or provision for the inclusion or integration of this assessment in the policies and practices of the financial sector in Cambodia. This shortcoming underscores the current need to scrutinise the social and environmental impacts possibly resulting from loans or lending to development projects.

The practice so far has been for project owners or clients receiving loans or credit from international banks (like ADB, WB or IFC) to diligently study and prepare environmental and social impact assessments to absolutely 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 communities in which they are located. The 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.

Code of Banking Practice (CBP): The ABC introduced the CBP in 2015, which asserts the criteria for providing credit to customers. Clause 12.1 of the CBP recommends that banks conduct diligent and prudent operations in assessing their customers' ability to repay credit facilities. There are five criteria set out to check information and data to examine credit repayment ability³. The code and requirements for pre-lending assessments do not emphasise environmental and social issues that may affect the client's business. These impacts may reduce the client's ability to repay the loan.

Cambodia Sustainable Finance Principles (CSFP): It was initiated by the ABC and endorsed by NBC in 2019. The main objectives of the CSFP are to:

¹ 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)

² 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)

³ 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.

- 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 CSFP, the NBC and the ABC signed a joint MoU with the MoE 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, contribution, responsibility, and commitment to achieving the goals of equitable and sustainable development.

The MoU sets out the following key commitments:

- Mutual collaboration and assistance to build capacity and raise awareness amongst officials, staff and individuals involved in sustainable financial practices
- Share information and documents related to sustainable financial practices.
- Collaboratively organise 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 organisations or institutions to develop and implement sustainable financial policies.

4. Conclusion and Recommendations

In this study, green financing is on the global agenda that several vital stakeholders have discussed. Promisingly, green and social finance from private sources has proliferated in recent years to contribute to sustainable finance. This will require all concerned vital stakeholders to promote sustainable green finance for mitigating adverse impacts to the environment and societies.

Endorsing environmental protection and natural resource management is an inter-disciplinary task requiring the engagement of key stakeholders, including state actors, the private sector and citizens. The provision of loans is a crucial way to promote and expand development or private investment, which is often observed to cause environmental and social harm.

Banking and financial institutions play an important role in Cambodia and significantly ensure a good investment climate for large development or investment projects, which provide employment opportunities, incomes, and Cambodia's developmental progress. In Cambodia, banking and financial institutions have yet to implement environmental and social impact assessment conditions to provide loans or credit to potentially risky projects. In contrast, several international banks like the Asian Development Bank, the World Bank, and the International Finance Corporation have developed strong environmental, forest, resettlement, indigenous, and regional security policies.

The absence of environmental and social safeguards in Cambodia's banking and financial sector is a significant concern. Credit from this sector has broadly contributed to many development or investment projects, some of which have damaged natural resources and the environment. Also, private financing is needed for Cambodia to achieve SDGs and climate goals. This challenge is due to 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.

Key Recommendations

- **Recommendation #1:** Awareness raising and capacity building for professionals, implementors and investors should be organised by the NBC for bankers, focusing on the definitions and criteria for green financing.
- **Recommendation #2:** Financial institutions should rethink their role in society by developing clear and ambitious environmental, social and governance policies. This could be done by benchmarking the green financing regulations and policies of the international standards.

- **Recommendation #3:** To motivate members of ABC to move forward in implementing the Cambodia Sustainable Financing Principles (CSFP), the regulators should consider rewarding any bank that fully complies with the CSFP. This could be done through tax exemption for banks that have gone through performance evaluation or assessment against the green finance indicators to be developed and assessed by NBC and NCSD. Banks themselves may also be provided better access to finance from the central bank.
- **Recommendation #4:** The NBC should conduct evidence-based research for use as a reference for the development of regulations or guidelines related to green and sustainable financing for Cambodia. Firstly is the obligation to avoid harmful activities. Secondly, financing needs to have significant positive

contributions: This could be done by adopting the ASEAN Taxonomy, which was issued by the end of 2021 to classify activities involving all sectors. At the same time, banks should be required to gradually increase the number of loans that align with the Taxonomy.

- **Recommendation #5:** The concept and implementation of green financing are relatively new in the Cambodian context, so capacity building on how to develop green financing policies should be provided to policy makers, especially the transparency and accountability of providing data on the implementation of green financing projects should be revealed to the public in Cambodia. The capacity of supervisors should also be increased, including through capacity building from other central banks (e.g., through the Network on Greening the Financial Sector).

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