



POLICY BRIEF

1. Introduction

The finance and banking sector has played an important role 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 both the nation and the people who are earning a living. The increase in the presence and large number of banking and financial institutions in Cambodia is a clear testament to the growth of economic activity, including the rise in investment projects or development projects proposed in compliance with the Development Policy of the Royal Government of Cambodia. These banking and financial institutions are a source of essential capital for investments. From an economic point of view, lending to development project owners is a positive effect, but some concerns and risks to the environmental and social resources of the lending project are different aspects that need to be seriously considered.

Obviously, the damage to resources by the activities of the development project is also an indirect involvement of the lending banking and financial institutions. Generally, before a loan is approved, the Bank evaluates and reports the financing of the project owner (with particular consideration for the ability or capability to afford the repayment) without evaluating or regarding the impact on the project obtaining such a loan, may entail a serious risk to the environment around the area where the projects are located. This lack of full demand for environmental and social impacts not only harms resources, but also causes the project itself to fail and be unable to repay banking and financial institutions.

According to the data in the annual report (2018)¹ of Credit Bureau Cambodia, as of 2018, a total of more than 3 million people in Cambodia are currently receiving loans or credits from financial institutions and a total amount of US \$20.854 million. Of those people, 57% are women who own those loans or credits. 17% of lenders have relationships with more than one financial institution².

2. Purposes of this Brief

- To identify policy gaps of both selected banks and Ministry of Environment (MoE) in promoting best practices of ESG compliance and propose alternative policies and practices to MoE and banks to ensure sustainable ESG compliance in Cambodia
- To identify banks' challenges and best practices of using EIA legal tools such as EIA report/EIA sub-decree from MoE to hold their business clients to be accountable for sustainable ESG practices in Cambodia
- To develop and present to key stakeholders, including MoE and National Bank of Cambodia/Association of Banks in Cambodia, policy recommendations for responsible and inclusive investment by the financial sector

3. Discussions on Study Results

For environmental sector, there are key legislatives 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-decrees³ on pollution

¹ CBC (2018). *Annual Report 2018*. Credit Bureau Cambodia. Phnom Penh. Cambodia.

² Ibid.

³ 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

control and Prokas on the use of term of references for some development projects⁴.

For environmental protection policy and in the context of environmental and social impact assessments, Cambodia's legal framework has not yet been given the attention to promote environmental and social issues and natural resource protection in banking and finance sector. The legislations that have been enacted in the past 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 banking and financial institutions in Cambodia. This shortcoming is a testament to the current need to prepare, consider, and begin to take into account the social and environmental impacts possibly resulting from loan or lending to development projects.

It has been so far practiced that project owners or clients who have received loans or credits from international banks (such as the Asian Development Bank, the World Bank, or the International Finance Corporation) have diligently studied and prepared environmental and social impact assessments in order to meet the absolute need to fulfill the rightful conditions of those banks. The needs 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 a number of large-scaled projects that could pose significant risks and impact on the environmental and social resources of the communities in which they are located. Due to financing that provides clients with sufficient capacity to clear, build, utilize resources, and operate their projects on a large scale, which may cause disruption or conflict with resources and livelihood activities of people in and around the project areas.

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 the negative impact on human health. It is imperative that banking institutions in Cambodia should begin to understand the consequences of loans or credits in reflection on damage to the quality of environment and social resources in order to reduce the risks that may affect their clients and development projects.

For finance and banking sector, there is no legal basis or provision institutionalizing environmental and social protection that is potentially affected by the financial and banking operations in Cambodia, except the Code of Banking Practice (2015) which guides the Association of Banks in Cambodia to emphasize the criteria in approving credit to clients based on the Sustainable Finance Principles. Its clause 12.1 recommends that the bank conduct diligent and prudent operations in assessing customers' ability to repay credit facility. Five criteria is set out to check information and data to study the ability of credit repayment. The code, as well as the criteria for pre-lending assessment, does not emphasize or take into account 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.

In the context of low motivation, high market competition, and limited awareness of the benefits of environmental and social protection among banking and financial operators and the public, finance and banking institutions have not yet practiced the requirement for ESIA in their loaning conditions. The best practice of this assessment process in the banking and financial sector was not available during this study period, as the Ministry of Environment as well as the National Bank of Cambodia has not yet identified a legal

management (2017), the sub-decree on urban waste and solid waste management (2015)

⁴ Prokas 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)

requirement for the current banking and financial institutions doing businesses in Cambodia.

4. Recommendations

- The Ministry of Environment and the Department of Environmental Impact Assessment should initiate or continue talks and discussions with the National Bank of Cambodia and the Association of Banks in Cambodia to find policy-forming solutions to promote the implementation of environmental and social requirements for bank's financing to the development projects, which exist 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 Memorandum of Understanding in 2019, the common policy, which is an example for the implementation of this Memorandum, includes "*the joint-declaration on the requirements of the environmental and social impact assessment report for the banking sector in Cambodia.*"
- As an entry point and to ease the work, National of Bank of Cambodia shall introduce a guiding policy (set as a requirement) to financial and banking institutions to apply or consider the policies and regulations in relation to environmental and social impact assessment (particularly the sub-decree no. 72, Prokas no. 021, 092, 116, 118, 119, 120 and 376) prior to their loan or credit approvals. In addition, the compliance report to these policies and regulations shall be regularly submitted to National Bank of Cambodia for archive and reference document and for future monitoring on their performance.
- Under the financial and technical assistance from its partners, the Ministry of

Environment, with the Department of Environmental Impact Assessment as its general staff, shall develop additional guidelines on required procedures and operational standards for environmental and social impact assessment that can be implemented with the banks in Cambodia. This procedure and standard include a joint-declaration (between the Ministry of Environment and the National Bank of Cambodia) on the requirements for social and environmental impact assessments in the banking sector, and a handbook on legal standards regarding environmental-social impact assessment, and procedures for monitoring and approving the environmental and social impact assessment report, the process of public participation in the environmental-social impact assessment study, the environmental observation, and some administrative formalities (i.e. Rapid Assessment Matrix for classifying environmentally risky loan projects), which can facilitate the bank's performance in implementing environmental and social impact assessment requirements on consumer loans.

- For the purpose of long-term environmental and social protection, the Ministry of Environment and the National Bank of Cambodia should provide guidance through a number of policies and implementation tools (such as relevant technical guidelines) to the lending bank, requiring the lender to establish an Environmental and Social Management System (ESMS) for its institution to ensure that environmental or social issues or risks which may result from the use of bank loans will be avoided, reduced or compensated for irreparable damages.

Supported by



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