

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

POLICY BRIEF

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 require serious scrutiny.

Obviously, the damage to resources by the activities of the development project can be indirectly attributed to the financial institutions funding the projects. Customarily, before approving a loan, banks scrutinize 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.

According to the CBC Annual Report (2018) data, 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.¹ Of those people, 57% are women, and 17% of lenders have relationships with more than one financial institution.²

2. Purposes of this Brief

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

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

² Ibid.

3. Discussion of the Study Results

For the environmental sector, there are several key legislative measures, 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 Prakas no. 376 on General Guideline for Preparing the Initial Environmental Impact Assessment*, (4) *2020 Prakas no. 021 on Classification of Development Projects for Environmental Impact Assessment*, and (5) other relevant sub-decrees³ on pollution control and Prakas on the use of term references for some development projects.⁴

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, with specific guidelines from the Ministry of Environment. 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.

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 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 environmental risks. It provides clients with sufficient capacity to clear, build, utilise 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 industrialisation, urbanisation, 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.

No legal basis or provision institutionalises environmental and social protection from Cambodia's financial and banking operations, except the *Code of Banking Practice (2015)*, which guides the ABC to emphasise 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.

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, the practice of requiring ESIA as conditions for loan approval remains unimplemented. ESIA best practices in the banking and financial sector were unavailable during this study period because neither the Ministry of Environment nor the National Bank of Cambodia made it legally mandatory for this sector as yet.

4. 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*

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

⁴ 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)

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 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.
- 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.
- 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.

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