IX

Cambodian Bond Market Challenges and Opportunities

This chapter discusses some of the real and perceived challenges facing the Cambodian bond and securities market, its policy bodies and regulatory authorities, as well as its participants, including potential issuers and investors that are nonresidents. This chapter also aims to describe the possible mitigating factors or market developments that could address these challenges in an appropriate manner.

A. Challenges in the Cambodian Bond Market

1. Absence of Government Bonds and Bond Yield Curve

The absence of government securities in Cambodia and the corresponding absence of a benchmark yield curve presents a challenge for any potential issuer—and their underwriters—to adequately determine the level of interest rates for issuances in the corporate bond market (see section B.2). As such, issuers will have to proceed carefully with their initial issuances in order to determine a suitable level of interest rates in comparison to bank loans, which are currently the prevalent means of financing for corporates. This, in conjunction with the expected level of disclosure for debt securities issuance—a standard that many issuers will take time to learn—may result in a slow start for the bond market's operation.

2. Need for Real-Time Gross Settlement System

Having an RTGS system is a vital infrastructure building block for any financial market. Particularly for a bond market, where transactions sizes are typically recorded in the millions of dollars or the equivalent in local currency, the need for a high-value payment system, typically administered by the central bank, is very important.

The NBC is working on the development of an RTGS system.

3. Capacity Building

As is a typical challenge in a nascent market, capacity building takes center stage. In Cambodia, this includes getting companies to develop a corporate governance culture comparable to other markets and in line with investor expectations (see also item 4).

The SECC is also seeking to license more market participants, including securities firms, and to accredit custodian banks, CRAs, and bondholders representatives to educate the public at large and to develop market knowledge that will lead to reliable practices and standards. For that purpose, the SECC began issuing dedicated *Prakas* for the accreditation of bondholders representatives and CRAs in August 2017 as part of the regulatory framework for the corporate bond market.

In turn, securities underwriters can nurture companies that are able and willing to issue securities and support the development of a corporate governance culture through their actions as well as those of issuers.

4. Corporate Governance as a Milestone to Securities Issuance

Similar to other nascent markets, a key objective will be for more domestic public companies to become listed companies (through equity listings) and/or to issue and list their future debt securities on the CSX. This process involves creating the discipline to disclose relevant information and the ability to use such discipline in the issuance of securities and their listing on CSX. This includes the need to produce and maintain auditable results, including financial statements comparable to other markets, so that investors, domestic and nonresident, can assess a company's performance. This process will also involve training intermediaries in servicing these public companies in an appropriate manner, including underwriters, auditors, and law firms to maintain, support, and enforce good corporate governance.

To provide guidance on the level of disclosure expected for the issuance of debt securities, the SECC has included substantial provisions on disclosure requirements in its Prakas on Public Offering of Debt Securities published in August 2017.

5. Conversion to Recognized Accounting Standards

Among the quantitative requirements in the CSX Listing Rules, a company must provide at least 2 years of audited financial reports prepared by an accredited international accounting firm approved by the Cambodian government to be eligible for listing.[33] This may be a challenge for potential issuers.

In the transition from public companies to listed companies, such potential issuers will need to acquire the ability to produce financial reporting in the formats adopted by the International Accounting Standards Board, referred to as International Financial Reporting Standards (IFRS). The National Accounting Council of Cambodia fully adopted IFRS Standards and IFRS Standards for SMEs through a *Prakas* issued by the MEF in January 2009.[34] Accordingly, issuers whose securities are traded in a public market—the CSX in Cambodia—were required to adopt IFRS Standards with effect from accounting periods starting on 1 January 2012. For commercial banks and microfinance institutions, the implementation of IFRS Standards became mandatory with effect from 1 January 2016.

At the same time, the ability to produce financial reports in IFRS format of listed issuers or typical issuers of debt securities in future, such as commercial banks, will make these securities principally accessible for both domestic and nonresident investors who may only invest in assets that provide international standards reporting. Moreover, these securities will also be able to be assessed for credit rating and investment analysis as a result of comparable reporting formats.

6. Transparency of Tax Processes

Equally significant to investors is the clarity of the taxation concepts and practices applied in the capital market, with a particular focus on capital gains and withholding taxes. While an Anukret on Tax Incentives in the Securities Sector was issued in 2011 and listed securities (referring to equities only) are exempt from withholding tax at present, the applicability of these concessions to debt securities once issued needs to

[33] For a complete list of CSX Main Board listing eligibility criteria, please see http://csx.com.kh/en/product/mainboard.jsp?MNCD=40302
[34] See http://www.ifrs.org/Use-around-the-world/Documents/Jurisdiction-profiles/Cambodia-IFRS-Profile.pdf

be either confirmed or tested. Until that has occurred, institutional investors may take a wait-and-see approach.

B. Opportunities in the Cambodian Bond Market

1. General Policy and Regulatory Environment in Cambodia

Since the global financial crisis, regulators around the world have been strengthening laws and regulations in capital and financial markets. Of particular interest have been banking regulations and the focus on risk-weighted capital. For financial markets, this includes limits on what banks can or are willing to lend, to whom, and under what circumstances. A number of these regulatory initiatives may, in consequence, lead to a rebalancing of funding options for the corporate sector from bank loans to capital markets.

This overall development might positively influence potential domestic issuers to consider raising funds via bond or note issuance, and to diversify their debt portfolio. Such increased interest, coupled with a broader and deeper investor base (see also item 4), might also have a beneficial impact on funding costs in Cambodia.

Just as these developments filter into individual markets in ASEAN+3, the SECC has begun to further define the regulatory framework for a bond market as an alternative means for company funding (see also item 2). At the same time, as the bond market in Cambodia is in a nascent stage of development, the SECC and other policy bodies and regulatory authorities have the unique opportunity to set objectives and implement regulations that seek to avoid potential pitfalls and focus on measures that have proven successful and practical elsewhere, adapting such measures to the needs of the Cambodian economy. An example is the introduction of a Qualified Investor regime in August 2016, using a clear and practical definition of a professional investor concept, in preparation for a professional market to international standards at a later date.

The availability of all relevant laws (*Kram*), regulations (*Anukret* and *Prakas*), and rules (e.g., CSX Listing Rules) in English through the websites of the CSX and the SECC greatly adds to transparency and the level of information available on the Cambodian securities market at large. As new regulations are published, the regulatory framework also continues to increasingly adopt international standards with regard to terminology and practices in the bond market.

2. Regulatory Framework for the Corporate Bond Market

In August 2017, the SECC introduced the necessary regulatory framework for the corporate bond market in Cambodia through the publication of a number of new *Prakas* (see also Chapter II.C). Each *Prakas* focused on a specific aspect of the market, from issuance and approval processes for public offerings to CRAs (and their requirements) and a bondholders representative function. For more details, please see the corresponding sections in Chapter III.

This framework created a new asset class in the Cambodian market and paves the way for the introduction of government securities beginning in 2019. This new asset class can address pent-up demand among the typical bond market investor universe (see item 4).

3. Listing of Debt Securities on the CSX is Principally Possible

The regulatory framework for corporate bonds introduced by the SECC in August 2017 also included the ability to list and trade nongovernment debt securities on the CSX. With the CSX exchange platform and processes being provided by joint venture partner Korea Exchange, which is experienced in debt securities trading and processing on its version of said platform, the market expects issuers to be able to list debt securities within a short timeframe. This would add visibility and transparency to bond issuance, listing, and trading practices in the Cambodian market.

4. Pent-Up Demand among Domestic Investors

Chapter III.M of the Cambodia Bond Market Guide lists the typical investor types in a bond market and the potential for such investors in Cambodia. Chief among them are insurance companies and pension or provident funds, which, based on their prudential mandates, are required to seek fixed-income instruments to generate a steady return. At the same time, the Law on the Issuance and Trading of Non-Government Securities, 2007 and supplementary regulations introduced collective investment schemes (e.g., unit trusts and mutual funds), which are also expected to invest in debt securities and, in turn, offer ordinary investors access to the bond market.

In the absence of a bond market, these investor types were limited to bank deposits at lower returns. They had no opportunity to diversify their portfolios, as is generally expected of them. The advent of the corporate bond market, with government securities to follow soon after, will offer these investor types suitable returns on, and better diversification of, their investments.