

TECHNICAL ASSISTANCE COMPLETION REPORT

Division: KYRM/CWRD

TA No., Country and Name: TA No. 4068 – KGZ: Capacity Building in Savings and Credit Unions and Microfinancial Systems			Amount Approved:		
			\$550,000		
			Revised Amount:		
			\$550,000		
Executing Agency:		Source of Funding:		TA Amount Undisbursed	TA Amount Utilized
National Bank of the Kyrgyz Republic (NBKR)		TASF		\$28,993	\$521,007
Date			Completion date		
			Original: 31 Dec 2003	Actual: 30 Sep 2006	
Approval: 19 Dec 2002 Signing: 13 Jan 2003 Fielding of First Consultant: 16 Feb 2003			Account Closing date		
			Original: 31 Dec 2003	Actual: 20 Feb 2007	
Description					
<p>The TA was approved in December 2002 in response to the Government's request to strengthen the capacity of the National Bank of the Kyrgyz Republic (NBKR) to regulate and supervise savings and credit unions (SCUs), established under the ADB-funded Rural Financial Institutions Project (RFIP),¹ and microfinance institutions (MFIs). The RFIP started in 1998 and aimed at creating a sustainable rural financial system based on SCUs that can both mobilize savings and increase the supply of credit to the people living in rural areas. The RFIP built the capacity of the Financial Company for Support and Development of Credit Unions (FCCU) established by the Government in 1997 and used it to develop and finance SCUs with funds provided by RFIP. The FCCU was also responsible for the day-to-day supervision of SCUs. The SCU system grew dramatically since then and reached about 300 SCUs in early 2002 surpassing the RFIP's set targets. Apart from SCUs, 18 MFIs were also operating in the country. In June 2002, 12 SCUs were found engaged in fraudulent practices that demonstrated that the rapid growth of SCUs outpaced the capacity of FCCU to supervise them effectively. An urgent assistance was, therefore, needed to conduct rapid assessment/audit of SCUs to ensure that the frauds detected in June 2002 were not widespread. Assistance was also required to strengthen SCUs and MFIs' supervision by (i) updating the SCU regulations to tighten the prudential requirements, provide for sufficient capital adequacy, and promote deposit taking; (ii) establishing adequate off-site and on-site monitoring and supervising systems with financial early warning to flag poorly performing institutions; and (iii) strengthening supervision capacities at FCCU and NBKR. The TA was approved to address these requirements.</p>					
Expected Impact, Outcome, and Outputs					
<p>The expected impact was a sound and viable financial system that can provide a range of financial services on a sustainable basis. The expected TA outcome was improved regulatory and supervisory capacity of NBKR and FCCU to ensure that both SCUs and MFIs are brought under an effective regime of supervision. The expected TA outputs were (i) revised and updated regulations governing operations of SCUs; (ii) recommendations and technical specifications for NBKR supervision of MFIs; and (iii) recommendations and technical specifications for SCU supervision function within FCCU. Close coordination with other international financial institutions (IFIs) involved in the sector capacity building was also envisaged to avoid overlapping.</p>					
Delivery of Inputs and Conduct of Activities					
<p>The formulation of the terms of reference for the consultants was appropriate. The TA envisaged fielding of four international consultants (ICs) for a total of 16 person-months (a SCU regulatory specialist, a SCU supervision specialist, a MFI off-site supervision specialist, and a MFI on-site supervision specialist). In addition, ten domestic consultants (DCs) with auditing experience were to be engaged for 10 person-months each as SCU supervisor, who were later supposed to be hired by FCCU supervision unit. All four ICs completed their assignments as scheduled. Later, one of ICs, MFI off-site supervision specialist, was re-engaged for additional 5.26 person-months to accommodate the Government's request to further harmonize MFIs' and SCUs' regulations and enhance supervision capacity of NBKR which resumed the day-to-day supervision functions from FCCU during TA implementation. The work of two ICs was rated highly satisfactory, and two satisfactory. The tenure of three DCs was extended to ensure continuity of supervisory work. They were all rated satisfactory.</p> <p>The TA was supervised closely and was implemented in accordance with the terms of reference. Coordination with other IFIs involved was adequate. The TA progress was reviewed jointly by ADB and NBKR on seven occasions after TA inception. The NBKR collaborated well with the consultants and provided adequate support. The performance of ADB, NBKR, and consultants in providing timely and adequate inputs has been satisfactory. However, due to transfer of the supervision function from FCCU to NBKR, more time was required for TA implementation to ensure sustainability of its outputs and, hence, the TA closing date was extended by 31 months.</p>					
Evaluation of Outputs and Achievement of Outcome					
<p>The TA outputs were produced in accordance with the TOR, delivered on time, and were of high quality which was confirmed by the Government. However, the TA outcome has been affected by the transfer of the supervision function from FCCU to NBKR in 2005 due to the conflict of interest for FCCU with regard to supporting SCU sector development through credits and being in charge for regulation and supervision. Therefore, the TA's planned outcome was achieved partly by assisting NBKR in setting up a supervision structure for MFIs and developing a more effective supervisory regime for SCUs. The outputs and major activities carried out under</p>					

¹ ADB. 1997. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Kyrgyz Republic for Rural Financial Institutions*. Manila.

the TA were as follow.

MFIs and SCUs' Operation Regulations. As was envisaged by the TA, a set of revised and updated regulations governing operations of SCUs developed by the consultants was formally adopted by NBKR, and incorporated into the RFI's Loan Agreement. Particularly, the economic and financial normatives were developed introducing the definition of capital, capital adequacy, and external borrowing limits to reflect both international best practice and local circumstances. Regulations also included outline conditions under which SCUs may be allowed to take deposits. As a result, SCUs are being supervised according to standard policies and procedures, and applying standard financial evaluation criteria.

NBKR's Supervision of MFIs and SCUs. Assistance was provided to develop an action plan to strengthen supervision which was followed by NBKR. As planned, the SCU regulations were harmonized with those of MFIs, adopted, and operationalized by NBKR. The consultants developed a set of recommendations and technical specifications for NBKR to supervise MFIs and SCUs. Given that the supervision function conflicted with FCCU's development objectives, and the fact that FCCU did not have capacity to carry out SCU supervision, the SCU supervision responsibilities and functions were transferred to NBKR effective July 2004. The consultants assisted in (i) formulating the general supervision strategy for NBKR; (ii) developing the on-site and off-site supervision manuals; and (iii) preparing the methodology, call report format, policies, and procedures for carrying out off-site supervision. As part of the improved call report system, the TA recommended use of CAMEL and its on-site methodology and PEARLS for its off-site review which was supported by NBKR.² The off-site reporting regulations were approved by NBKR in March 2007 and the system is fully operational now. The TA also developed modules for training inspectors on supervision of credit unions. Computers were supplied and on-the-job training was provided to NBKR staff. The first batch of on-site examinations of SCUs was undertaken in 2005 and continued in 2006 with more than 53% of SCUs loan portfolio examined. By 2007, six SCUs received licenses for deposit taking. Currently, the NBKR non-banking supervision unit is fully staffed and carrying out supervision of MFIs and SCUs.

SCU Supervision within FCCU. The TA helped develop a workable action plan for supervision of SCUs. Recommendations were made to strengthen FCCU's corporate governance, namely with regard to its supervisory board, establishing overall policy and strategy for FCCU. The FCCU's turnaround plan was amended in line with the TA recommendations. Domestic consultants/supervisors conducted rapid assessment of majority of SCUs in 2002-2003 to ensure that the fraud detected in 2002 were not widespread. In 2004, the day-to-day SCU supervision function was transferred to the NBKR's non-banking supervision unit to ensure effective supervision of SCUs. The supervisors were trained and were to be hired by FCCU. However, after transfer of supervision function to NBKR, only one of ten trained supervisors was recruited to the NBKR's non-banking supervision unit. At the request of SCUs supported by NBKR, the TA savings were made available to finance the distance training for SCUs staff to enhance their capacity in accounting and banking. A total of 63 SCU staff successfully completed training and received certificates at local vocational education institutions.

Overall Assessment and Rating

The TA was valued highly by the Government. The TA expected impact and outcome were consistent with the Government's priorities. Overall, the TA design was appropriate for accomplishing its objectives with the exception of the enhanced supervision capacity at FCCU which could not be accomplished due to transfer of this function to NBKR. Therefore, the TA outcome was partly achieved. The NBKR and the FCCU demonstrated strong ownership by actively participating in all TA activities. The training of 63 SCU staff using the TA savings was over and above the TA scope and was useful in ensuring sustainability of the SCUs. Inputs were less efficiently used as the implementation process was affected by transfer of supervision function from FCCU to NBKR and an evident loss of momentum in capacity building. Also, a part of capacity built under the TA was lost as nine of the ten supervisors trained did not join NBKR. Although, the TA outcome is likely to be sustainable as the key outputs were institutionalized and are currently in use, the impact of TA on institutional development is likely to be moderate due to the high staff turnover at NBKR. Therefore, overall the TA is rated as partly successful.

Major Lessons

The TA would fully achieve its expected outcome if it was focused at capacity building for SCU and MFI regulation and supervision at NBKR. The TA design would have adequately reflected this strategic shift if an adequate microfinance development strategy with clear supervision development objectives would have existed at the time when the TA was designed. To mitigate such changes in institutional structures involved in the TA while TA is being implemented, adequate arrangements should be in place to ensure the capacity built is sustained and the staff trained are retained at their positions.

Recommendations and Follow-Up Actions

Further assistance is required in the context of the Government's microfinance strategy to (i) further strengthen capacity in SCUs and MFIs supervision, (ii) support the development of SCU apex services, and (iii) help SCU system develop its own controls.

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² CAMEL is the international rating system of banking performance measurement used by NBKR where the assessment is conducted based on capital adequacy, asset quality, management, earnings, and liquidity. PEARLS is a financial performance monitoring system designed to offer management guidance for credit unions with the terminology used to represent key classes of ratios related to protection, effective financial structure, asset quality, rates of return and costs, liquidity, and signs of growth.