

TA COMPLETION REPORT

Division: ECGF

TA No. and Name TA 3239-KGZ: Institutional Strengthening of the Financial Sector			TA Amount Approved US\$600,000.00	
			Revised Amount	
Executing Agency Ministry of Finance			TA Amount Undisbursed US\$31,264.40	TA Amount Utilized US\$568,753.60
Approval 9 August 1999	Date Signing September 1999	Field Late 1999	Original May 2000	Closing Date Actual September 2001
TA Description				
<p>During 1998 and 1999, in view of its weak economic base, the Kyrgyz Republic was severely affected by the fall in commodity prices and the Russian and Asian crisis. Growing economic distress adversely affected the financial sector. Most banks suffered marked deterioration in their portfolios. Trading activities on the nascent security markets dropped dramatically. To strengthen the financial sector and facilitate recovery from the crisis, the Government developed a coherent strategy supported by the ADB's SDR25.2 million Financial Intermediation and Resource Mobilization (FIRM) Program Loan, approved in December 1999. The policy framework of FIRM included four components: (i) restructuring and consolidating the banking system, (ii) developing the Government's securities market, (iii) facilitating the development of the equity market, and (iv) promoting the institutional investor sector.</p> <p>TA 3239-KGZ was designed to assist the key regulatory agencies of KGZ, namely the National Bank of Kyrgyz Republic (NBKR), National Securities Commission (NSC), and State Insurance Supervision Authority (SISA), in undertaking the comprehensive reform agenda proposed under FIRM. The TA build on assistance, which had been provided under World Bank's FINSAC program, an associated financial sector TA, which had been approved from the World Bank in June 1996, and bilateral assistance which had been provided through USAID.</p>				
TA Objectives and Scope				
<p>The TA was to support institutional strengthening of the three key regulatory and supervisory agencies overseeing different segments of the financial markets. This included advice and support to:</p> <ul style="list-style-type: none"> (i) NBKR on banking sector reform strategy, deposit protection, restructuring of individual banks, banking supervision, accounting and auditing requirements, loan classification, reserve policy, and foreign investment in the sector; (ii) NSC on regulation and supervision procedures, privatization through stock exchange, management information systems, investors protection, and disclosure rules; (iii) SISA on prudential norms and investment guidelines in accordance with international standards and best practice, management information systems, and regulatory framework for reserve funds. <p>In addition, in 2001 NBKR and MOF requested to provide services of a Banking Sector Expert to</p> <ul style="list-style-type: none"> (iv) advise the management of state owned Kairat Bank (KB) on managing its loan portfolio, assess prospects of the bank, and formulate a business strategy. In addition, the expert had to assist the ADB Loan Review Missions by undertaking a review of the overall banking environment in KGZ and assessing the ongoing resolution attempts to address the problems in other banks. 				
TA Inputs Evaluation				
<p>The TA was appropriately designed. The implementation complied with the terms of reference (TOR). The TOR had to be widened in 2001 to respond to an urgent request of the MOF and NBKR, to address emerging problems of growing complexities of KB. The completion date of the TA was extended to 30 September 2001, accordingly.</p> <p>The TA required 19 person-months of service of international consultants and 5 person-months of service of domestic consultants. Consultants were recruited in accordance with ADB's Guidelines on the <i>USE of Consultants</i>. The consultants provided inception reports to MOF, the IAs, and the Bank, within one month of the commencement of services, as well as monthly reports on TA progress and key policy developments, and presented final reports incorporating comments received from ADB and the Government at the end of each component. One individual consultant who delivered advice on KB was rated excellent. All other consultants were rated satisfactory. Initial problems of the IAs to provide all facilities budgeted under government financing were overcome soon. NBKR provided timely access to data and information and interacted well with high and working level Missions.</p>				

TA Outputs Evaluation

The TA has significantly contributed to

- (i) Strengthening the supervisory function of the NBKR. Principal activities supported by the TA were the development of methodologies and procedures for off- and on-site banking supervision, development of implementation plans for accounting and auditing, assessment of procedures for loan classification, recommendation for an appropriate reserve policy, and definition of minimal capital requirements.
- (ii) Formulating a banking sector reform strategy as well as restructuring plans for individual banks. Options to change the structure of the banking system were developed and discussed with NBKR. An action plan for closure or recapitalization of failed banks was reformulated and a unit to deal with problem banks established in NBKR. The strategy of increasing minimum capital requirements was discussed with the NBKR under the TA in close coordination with IMF experts.
- (iii) Evaluating the proposed deposit protection system (DPS) and negotiating amendments to insure that the draft law on DPS is applicable under local conditions and up to international standards.
- (iv) Strengthening the supervisory function of the NSC. Although NSC had sufficient automation, the TA helped in reviewing regulation and supervision procedures, developing and implementing a management information system, markedly improved the dissemination of trading information from the stock exchange to NSC, and assisted NSC and Kyrgyz Stock Exchange (KSE) to build up its surveillance capability.
- (v) Developing the security markets. The Government strategy for capital market development was reviewed, which included procedures for privatization of state companies through the stock exchange, which increased considerably under FIRM, and the establishment of a secondary market for treasury bills at KSE. Advice was given to NSC on protection of investors and the setup of an Investors Compensation Funds. Advice was given to KSE concerning its charter, listing requirement, and a public information library. Advice was given to the authorities to remove tax distortions on trading in securities by amending the Tax Code.
- (vi) Capacity building in SISA. As SISA was at the very beginning of systematizing its information requirement, the TA focused on extensive remedial training of staff, technical papers as well as seminars on the mechanics of insurance, and public relations measures, rather than the introduction of a management information system. A detailed practitioners' manual was provided under the TA. SISA and most of its staff was incorporated into the non-bank supervisory department of MOF during the TA period. Contrary to initial expectations, supervision on insurance companies has subsequently been markedly strengthened. Supervision on other non-bank financial institutions like investment-funds and pension-funds, however, is still at a nascent stage.
- (vii) Supporting NBKR and MOF in formulating measures to strengthen KB in 2001. These measures included the transfer of NPLs from KB to the state asset management company (DEBRA), the recapitalization of KB by MOF, and reformulation of KB's balance sheet. As a consequence, KB has operated profitably since May 2001.
- (viii) Developing and implementing a forward looking business plan aimed at maintaining solvency and increasing profitability in preparation for KB's eventual privatization. The importance of recommendations given under the TA has been highlighted by both, MOF and the new management of KB.

TA Overall Assessment and Rating

Highly successful. The TA had significant impact on strengthening NBKR, NSC, Insurance Sector Supervision and Kairat Bank, and served as a useful tool for conduct of policy dialogue both at high and working level, which fed into effective implementation of FIRM. The TA contributed to the creation of a legal and regulatory framework conducive to development of finance sector. In view of culmination of TA provided by USAID for the development of capital markets, the inception of ADB's TA was both timely and needed to fill the void left by other donors in the area.

Major Lessons Learned

It proved extremely important to flexibly react to requests of the EA and the IAs, which were confronted with many unforeseen challenges during the program period. The loss in independence of a supervisory agency, namely SISA, does not necessarily lead to the deterioration in quality of supervision in the short run, even if independence is for principal reasons an important precondition for the credibility of every supervisor.

Follow-Up Action and Recommendations

There is still need to further strengthen non-bank regulation and supervision, through capacity building in human resources and information technology, as well as effective enforcement of corporate governance in financial institutions. The question of independence of capital market and non-bank supervision from other government organizations, namely the Ministry of Finance, should be addressed in the medium to long run. Further TA to Kairat Bank should not be given before the authorities have arrived at a decision to widen business activities beyond investment in government securities and, namely, to lift the restrictions that prevent KB from any lending activities.