ADB

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Regional: Financial Sector Development in Central and West Asia

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Country Assessment Uzbekistan

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Asian Development Bank

CURRENCY EQUIVALENTS

(as of 31 December 2011)

Currency Unit	–	SUM
SUM1.00	=	$0.00056
$1.00	=	SUM1,795.00

ABBREVIATIONS

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
CBs	–	Commercial Banks
CGAP	–	Consultative Group to Assist the Poor
CIS	–	Commonwealth of Independent States
EBRD	–	European Bank for Reconstruction and Development
GDP	–	Gross Domestic Product
GIZ/GTZ	–	Deutsche Gesellschaft für Internationale Zusammenarbeit
IAA	–	International Actuarial Association
IAIS	–	International Association of Insurance Supervisors
ICT	–	Information and communications technology
IFC	–	International Finance Corporation
IFRS	–	International Financial Reporting Standards
IMF	–	International Monetary Fund
JSC	–	Joint Stock Company
KfW	–	Kreditanstalt für Wiederaufbau
NAMOCU	–	National Association of Micro-finance Organizations and Credit Unions
MTS	–	Interbank Trading System
RETA	–	Regional Technical Assistance
SMEs	–	Small and medium enterprises
TRSE	–	Tashkent Republican Stock Exchange
UNDP	–	United Nations Development Programme
USAID	–	United States Agency for International Development
$	–	US Dollar
SUM	–	Uzbekistan sum

NOTES

(i) The fiscal year of the government and its agencies ends on 31 December

(ii) In this report, “$” refers to US dollars unless otherwise stated.

CONTENTS

EXECUTIVE SUMMARY

This report contains the results of the Uzbekistan Country Assessment within the Technical Assistance–7709 (REG) Financial Sector Development in Central and West Asia. The technical assistance continues Asian Development Bank (ADB) work in the finance sector in Central and West Asia, where it has used modalities such as technical assistance, program loans, and credit lines to support various aspects of the financial sector's development.

Overall the technical assistance aims to improve understanding of (i) electronic payment systems, (ii) the securities market, (iii) insurance and (iv) micro and small enterprise finance as an important topic for economic development. Through its review of these sectors it aims to identify the opportunities and the constraints as well as areas where ADB in Uzbekistan can provide support through technical assistance or project or program lending. The output of the study is a set of proposed demand-driven activities in coordination with other donors, which forms a strong project preparatory technical assistance.

Uzbekistan's real gross domestic product (GDP) growth is among the highest in Central Asia. Supported by the extended effects of the fiscal stimulus, the government's medium-term investment program, and the gradual global economic recovery, its GDP has grown substantially. In 2011, GDP grew 8.3%, driven mainly by industry (including construction) and services—with growth rates of 6.7% and 12.7%, respectively[1]. It is forecast to grow by 8.0% in 2012 and 7.9% in 2013, with rising state-led investments expected to offset a decline in exports. Industry and services are expected to remain the main contributors, with industrial output supported by higher domestic lending and foreign investment, and services driven by higher domestic demand, especially from the public sector. At the end of 2010, GDP per capita was estimated at $1,280.[2]

The size of the financial sector remains small relative to GDP in comparison to similar sized economies in the region. As of December 2011, Uzbekistan had 30 commercial banks with 822 branches and about 1,800 minibank offices, 34 microcredit organizations, 48 pawnshops, 37 insurance companies, and 46 leasing companies.

At the end of 2011, bank deposits amounted to 23.2% of GDP and bank credit was 20.1% of GDP, up from 17% in 2010. Outstanding bank loans as of 31 December 2011 totaled SUM15.6 trillion ($8.7 billion), of which investment loans are SUM4.4 trillion ($2.45 billion). Micro and small enterprises borrowed from banks SUM4 trillion ($2.2 billion), which contributed to 291,000 in new job creation, while micro-credits totaled SUM752.3 billion ($419.1 million). Of this $143.4 million of loans were borrowed by small businesses on foreign credit lines in US dollar and local currency. There is also a stock exchange which is in the early stages of development, with equity market capitalization at 9.7% of GDP in 2011.

The range of loan and deposit products is limited, restricting the use of domestic resources. Remittances are estimated at 16% of GDP, while people from Uzbekistan working in the Russian Federation, alone, sent $4.9 billion in 2011. Financial institutions need to look at offering a more comprehensive range of financial services to fit the requirements of households and businesses, including links among services that include credit, deposits, and insurance. Assistance in identifying and testing new products and the provision of longer-term finance would be useful.

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1 ADB. 2012. *Asian Development Outlook 2012: Confronting Rising Inequality in Asia*. Manila.
2 Footnote 2.

There is an underlying lack of confidence in the financial system . This stems from a history of sudden policy changes and inconsistent application and interpretation of policies including: (i) difficulties faced by bank customers in withdrawing cash from bank accounts, resulting in a low bank-deposit-to-GDP ratio of 23.2%;[3] (ii) a policy environment of state 'directed' lending to state-owned companies, crowding out private funding availability and market-driven pricing; and (iii) weaknesses in the policy environment impacting the effectiveness of reforms, financial products and their delivery capacity and mechanisms.

Under the instruction of the Central Bank of Uzbekistan, all 123 credit unions had ceased operations by the end of October 2011. In December 2011, the Board of Directors of the Central Bank of Uzbekistan adopted amendments to the regulation on licensing order of microcredit organizations' activity requiring all microcredit organizations to increase chartered capital to €100,000 (currently €10,000 in rural and €20,000 in urban areas). They are required to make this increase in minimum capital by January 2013. It is likely that some former credit union stakeholders may apply for microcredit organization licenses.

E-commerce or e-payments in Uzbekistan are currently available primarily via plastic cards, which are issued by commercial banks. These cards are used largely for processing salaries, that is, employees receive salaries directly to their card accounts. While these payments are relatively well catered for within the banking system, use of the funds stored in these accounts can be improved through the expansion of the e-payments networks. Currently there is a limited network of payment terminals across the country which accept the cards and cardholders can only withdraw cash at bank branches, often only after prior request. Use of other technologies, such as mobile, to affect similar e-payments is also an area of potential growth. Constraints need to be addressed, including regulation of both e-money and branchless banking, the interoperability of e-payment systems, and capacity building of all players in the e-payment environments from clients to regulators.

There are 34 non-life insurance companies, 2 life, and 1 reinsurance. The market is in the early stages of development, with insurance penetration at 0.40% of GDP in 2011. The total amount of premiums paid in 2011 was SUM231,6 billion ($129 million). Major insurance products include compulsory motor insurance, compulsory employer's liability, contractor's all-risk insurance, property insurance (against pledges and all types of catastrophes), and export credit insurance. The slow penetration of general insurance and negligible growth of life insurance can be attributed to regulatory, social, human development, and cultural factors, as well as the state-dominated market structure. Constraints need to be addressed, including (i) weak competition in the insurance market, where premium discounting is a common practice; (ii) insurance agents' poor knowledge about the products they sell; (iii) an unbalanced relationship between the insured and the insurer, which favors industry profitability but undermines the development of the market; (iv) difficulty in regulating solvency requirements of private insurers; (v) lack of separation between shareholder funds and policyholder funds; and (vi) low per capita income..

The securities market in Uzbekistan is in an stage of development. Constraints include: (i) the relatively stable development of share prices since 2007, which cast doubt on whether prices reflect underlying asset values; (ii) a small government bond market which exists only as a 'nominal' market with bonds being placed directly by the central bank to banks (usually state-owned banks); (iii) the absence of unified financial statistics; (iv) limited publicly available information on government bonds or on the government's debt management strategy; and (v) limited exchange rate flexibility with reported delays with convertibility. Reliance on directed

[3] Consultant' calculations as of end-2011. based on the Central Bank and State Statistics Committee of Uzbekistan. *Annual Statistical Review.* Tashkent.

lending limits the development of a sound credit culture in which lending is based on underlying fundamentals, thereby facilitating the growth of market-driven pricing. At the same time, weaknesses in the policy environment are impacting the effectiveness of reforms, financial products, and their delivery capacity and mechanisms. The development of the Uzbekistan securities market is also complicated by the need for reform in other sectors of the economy. Many of the large commercial banks are for example indirectly owned by the state as major shareholders are state-owned enterprises. Many non-financial enterprises also have sizeable state shareholdings.

To increase access to finance in rural areas, the development of mobile financial services could be pursued to ensure that rural populations have access to affordable, effective, and inclusive financial services using mobile phones. Support could be provided to (i) review the regulatory framework for e-payment supervision, e-signatures and branchless banking; (ii) provide assistance in addressing the infrastructure issues restricting the widespread uptake of mobile payments, internet banking, point of sale payments and the use of unified plastic cards; and (iii) provide capacity building to allow e-payment for consumers, merchants, service providers, e-payment providers and central bank supervisors.

To achieve greater outreach of insurance there is a need to develop a stronger policy and regulatory environment for insurance. Support could (i) provide recommendations on changes to the policy and regulatory framework, (ii) develop an electronic document management system, (iii) explore new insurance products and distribution channels, and (iv) provide capacity building for insurance regulator and market participants.

To achieve a deeper and more diversified nonbank financial sector, the contribution of the banking sector to economic growth needs to be expanded and the nonbank financial sector needs to be strengthened to underpin domestic savings. Support could develop (i) policy and consensus building, (ii) a primary market for government securities, (iii) a secondary market for government securities, and (iv) the corporate bond market.

1. INTRODUCTION

1. Technical Assistance–7709 (REG) Financial Sector Development in Central and West Asia is a continuation of the Asian Development Bank's (ADB) work in the financial sector in Central and West Asia. Support for various aspects of the financial sector has come from technical assistance,[4] program loans, and credit lines. These modalities have seen loans go to micro- small and medium-sized enterprises, the strengthening of the legal and regulatory frameworks, and assistance for institutional capacity building processes.[5] The technical assistance also addresses the situation in Central and West Asian countries, where—to varying degrees—financial sectors were impacted by the global financial crisis in 2008, and wherein generally the financial sector does not sufficiently sustain economic growth.

A. Objectives of the technical assistance Financial Sector Development in Central and West Asia

2. The aim of the technical assistance is to improve the understanding of credit demand, supply, and constraints in the Central and West Asian countries and to improve the enabling environment for financial sector development in the region. Indicators will track several factors of financial development, including: (i) the ease of access to loans; (ii) the quality of regulation of securities exchanges; (iii) the availability of financing through local equity markets, and (iv) the soundness of banks and insurance companies. It also aims to increase the impact and outcomes of ADB financial sector operations in Central and West Asian countries and to define areas for ADB support. At the conclusion of each study, a road map in selected financial subsectors is proposed for each country, which in close communication with respective governments will lead to the identification of further financial sector interventions. Each study provides a set of proposals for activities that are demand driven and coordinated with other donors, forming a strong project preparatory technical assistance.

3. The technical assistance is organized into two components. The first of the components encompasses (i) financial sector assessments and surveys; (ii) preparation of cross-cutting regional knowledge products and working papers, and; (iii) preparation of product-focused action plans based on country demand. The second component provides training and capacity building programs. Both components cover Afghanistan, Armenia, Azerbaijan, Georgia, Kazakhstan, the Kyrgyz Republic, Pakistan, Tajikistan, Turkmenistan, and Uzbekistan—with the latter the starting point and pilot country for the technical assistance.

B. Objectives and Methodology of the Uzbekistan Country Assessment

1. Objectives

4. The country assessment aims to develop a roadmap for ADB intervention(s) through in-depth studies of selected financial subsectors. It is intended to give a fair picture of the subsectors, review the respective activities of the Uzbek government and of ADB fellow donors, as well as appraise ADB assistance in the sector. The assessment identified the following subsectors after extensive consultation with government agencies, financial institutions and associations, as well as with donors active in Uzbekistan:

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4 ADB applies several technical assistance instruments, which it finances with grants and loans, including project preparatory technical assistance; project implementation technical assistance; advisory technical assistance; and regional technical assistance. Source: http://www.adb.org/ta/default.asp.

5 The present regional technical assistance is already the second program for the Central and West Asia Department.

(i) micro and small enterprise finance;
(ii) electronic payment systems;
(iii) the insurance sector; and
(iv) the securities market.

5. Based on the findings of the report and demand from the Ministry of Finance, a stand-alone technical assistance has been developed for the further development of the insurance sector. This has been developed in close coordination with the State Insurance Supervision Board under the Ministry of Finance as well as with other donor organizations involved in this sector.

2. Methodology and Organization of the Report

6. Prior to the country assessment, a desk study (the study) was prepared and submitted to ADB in September 2011. The basis for the study was an ADB inception mission in May 2011[6], which defined the study to provide a summary of status in various subsectors, pre-selected in consultation with the government.[7] The study highlighted constraints, raised questions, and formed the starting point for issues to be clarified and discussed with the Uzbekistan Resident Mission and the government to realize a common understanding of particular requirements. The study took into account the institutional framework of ADB´s overall *Strategy 2020*, the Uzbekistan country partnership strategy, and government priorities, formulated mainly by Resolution PP-1438.[8]

7. Key stakeholders, consultants and ADB staff discussed the regional technical assistance and potential areas of focus during a reconnaissance mission[9] to Tashkent from 12–22 September 2011 develop results-based financial sector action plans. A further mission[10] from 28 November–2 December 2011 under the RETA[11] discussed with the Central Bank of Uzbekistan, other relevant government agencies, financial institutions and donors a proposed road map designed under the regional financial sector technical assistance for developing e-commerce and electronic banking. It also discussed a request for a stand-alone technical assistance for the development of the insurance sector.

8. The assessment is constrained by the lack of available and reliable data, impacting the analysis and precision of subsequent road maps. The government's sudden closure of credit unions was a further constraint to the work. Credit unions were an important part of micro and small enterprise finance, and the details of their ongoing closure unfolded during the September mission.

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6 The inception mission responded to the Central Bank of Uzbekistan's request for ADB support in the financial sector, including capacity building. The mission clarified development partner activities in the financial sector.

7 Micro and small enterprise finance, insurance and micro-insurance, e-commerce, securities markets development, and housing finance. Meanwhile, ADB has current programs for micro, small and medium enterprise and housing finance, while all other sectors are new to ADB in Uzbekistan.

8 Presidential Resolution No. PP-1438, of 26 November 2010, on *Priority Areas for Further Reforms and Sustainability Improvement of Country's Finance and Banking System in 2011-2015 and Achieving High International Ratings*; and Presidential Resolution No. PP-1474 of 7 February 2011 *On the Year of Small Business and Private Entrepreneurship* State Program, Tashkent, Uzbekistan.

9 Lotte Schou-Zibell, Senior Economist, CWPF, ADB was mission leader. Mission members from the Frankfurt School of Finance & Management included Ute Zimmermann, Patricia McKean, Otabek Rakhimov, Silke Mueffelmann, and Bobir Gafurov, Uzbekistan Resident Mission,.

10 The Mission in Uzbekistan comprised L. Schou-Zibell, Senior Economist, CWPF (Mission Leader); B. Gafurov, Senior Private Sector Development Officer, URM; A. Chatterjee, Senior Financial Sector Specialist, OREI; and RETA consultant from Frankfurt School of Finance and Management: G. O'keeffe.

11 ADB. 2011. *TA for Financial Sector Development in Central and West Asia.* Manila (TA–7709-REG).

2. THE FINANCIAL SECTOR OVERVIEW

A. Macroeconomic Development

9. Uzbekistan's gross domestic product (GDP) growth is among the highest in the region. Supported by the extended effects of fiscal stimulus, the government's medium-term investment program, and the gradual global economic recovery, Uzbekistan's gross domestic product grew substantially, with annual growth in 2011 of 8.3%, driven mainly by industry (including construction) and services, with growth rates of 6.7% and 12.7% respectively.[12] GDP is forecast to grow 8.0% in 2012 and 7.9% in 2013, as rising state-led investments offset a decline in exports. Industry and services are expected to remain the main contributors to economic growth; industrial output will be supported by higher domestic lending and foreign investment, while services will be driven by higher domestic demand, especially from the public sector.

Table 1: Real GDP Growth (%)

Country	2004	2005	2006	2007	2008	2009	2010	2011
Afghanistan	9.4	14.5	11.2	13.7	3.6	21.0	8.4	5.7
Armenia	10.5	13.9	13.2	13.7	6.9	(14.1)	2.1	4.5
Azerbaijan	10.2	26.4	34.5	25.1	10.8	9.3	5.0	0.1
Georgia	5.9	9.6	9.4	12.3	2.3	(3.8)	6.3	7.0
Kazakhstan	9.6	9.7	10.4	8.9	3.3	1.2	7.0	7.5
Kyrgyz Republic	7.0	(0.2)	3.1	8.5	8.4	2.9	(0.5)	5.7
Pakistan	7.5	9.0	5.8	6.8	3.7	1.7	3.8	2.4
Tajikistan	10.3	6.7	6.6	7.8	7.9	3.9	6.5	7.4
Turkmenistan	5.0	13.0	11.4	11.1	14.7	6.1	9.2	9.9
Uzbekistan	7.7	7.1	7.4	9.5	9.0	8.1	8.5	8.3

Source: ADB. 2012. Asian Development Outlook 2012: *Confronting Rising Inequality in Asia.* Manila.

10. An improved trade balance and higher remittances helped raise the current account surplus to 8.1% of GDP in 2011, from 6.6% in 2010. Exports of goods and services rose by 28.6% as international prices for gold, cotton, copper, and natural gas reached record highs, and amid strong consumer demand from the Russian Federation. Imports of goods and services grew 26.5% in 2011, with machinery and equipment the main import items needed for industrial modernization and infrastructure development. The current account is expected to decrease to 7.5% of GDP in 2012 and to 6.0% of GDP in 2013, however, as the trade balance weakens. Declining international prices for the country's main exports, excluding natural gas, coupled with weaker external demand, is likely to hamper export performance, with exports forecast to rise moderately in 2012 and decline in 2013. The recession in the European Union and lower expected growth in the Russian Federation and the People's Republic of China (PRC) are also expected to impact export growth. Import growth is forecast to slow in both 2012 and 2013, despite infrastructure spending and the government's industrial modernization program.

11. Rising remittances, increased domestic lending, and wage and pension hikes boosted private consumption in 2011. However, given weaker growth projections in the Eurozone and important trade partners, additional measures, including further wage increases and welfare payments are likely.

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[12] ADB. 2012. *Asian Development Outlook 2012: Confronting Rising Inequality in Asia*. Manila.

12. Uzbekistan's currency, the sum, depreciated against the US Dollar[13] by 9.5% in 2011,[14] exceeding its decline in 2009 and 2010. The interbank interest rate, that parallels the Central Bank of Uzbekistan refinancing rate, was reduced on 1 January 2011 to 12% from 14% with no change until the date of this report.

13. Government sources put 2011 inflation at 7.6%, and alternative sources at an estimated 13.1%.[15] This reflects public sector and pension increases of 26.5% since December 2010, with high foreign exchange inflows, rapid credit growth, local currency depreciation, and increased private and public spending. To mitigate inflationary pressures, the central bank issued certificates of deposit (equivalent to 40% of the existing stock of certificate of deposits) to sterilize excess liquidity, while the government absorbed $1.6 billion of export revenues into the Fund for Reconstruction and Development of Uzbekistan, its sovereign wealth fund. Inflation is forecast at 9.5% in 2012 and 9.0% in 2013, as global commodity prices decline. Continuing currency depreciation will, however, help keep import prices high.

Fiscal Sustainability

14. The general government budget balance, including the Fund for Reconstruction and Development of Uzbekistan, is estimated at 3.2% of GDP in 2011. Higher revenues from higher commodity prices and improved tax administration offset rising expenditures associated with wage and pension increases, higher social outlays, and investments in the government's rural development program. Overall expenditures increased from 34.4% of GDP in 2010 to 35.3% of GDP in 2011. Foreign direct investment inflows were $2.9 billion, of which 79.0% was directed mainly to the fuel, energy, petrochemical, and automobile manufacturing sectors. Total external debt is estimated to have increased to 17.5% of GDP in 2011 from 14.7% in 2010.

B. Financial Sector: Structure and Development

15. The global financial crisis starting in 2008 has had limited impact on Uzbekistan's financial sector because of (i) cautious pre-crisis financial sector policies, (ii) Uzbekistan's limited integration with world markets, including low penetration of foreign capital, (iii) the absence of conventional financial markets, and (iv) stimulus measures to augment financial system solvency and liquidity.[16] These latter measures included (i) gradual introduction of market forces into the banking system, establishing capital markets, and developing nonbank financial institutions; and (ii) further increasing effective access to financial services, for example by stimulating the expansion of microfinance. Financial disclosure, supervisory, and regulatory systems are broadly in line with international standards.[17] Other significant achievements include a well-organized payment system and efficient internal management information systems in leading banks.

16. The size of the financial sector remains small to GDP in comparison to similar size economies. As of December 2011, Uzbekistan had 30 commercial banks with 822 branches

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[13] Official exchange rate as of 31 December 2011: $1.0 = SUM1,795.00 .
[14] Central Bank of Uzbekistan.
[15] ADB. 2012. *Asian Development Outlook 2012: Confronting Rising Inequality in Asia.* Manila.
[16] Although Uzbekistan's financial sector was less integrated into world markets, certain financial institutions were exposed to Uzbek industries whose exports suffered, which affected these financial institutions' portfolios.
[17] The major laws regulating the financial sector are the *Law on the Central Bank (1995)*, the *Law on Banks and Banking Activity (1996)*, the *Law on Joint Stock Companies and Protection of Shareholders' Rights (1996)*, the *Law on Bankruptcy (2003)*, and the *Law on Currency Regulation (2003)*. Banks are required to follow Basel I capital adequacy guidelines and financial disclosures according to International Financial Reporting Standards and their audit according to International Standards on Auditing.

and about 1,800 minibank offices, 34 microcredit organizations, 48 pawnshops, 37 insurance companies, and 46 leasing companies.[18] There is also one stock exchange. Total assets of all commercial banks are $15.3 billion, which makes 35,3% of Uzbekistan's GDP in 2011.

Table 2: Financial Institutions, 2011

Financial Sector Development	Number
Commercial Banks	30
of which	
Wholly state-owned	3
Joint-stock with minority state ownership	13
Private join-stock	9
Banks with foreign ownership	5
Micro Credit Organizations	34
of which Hamkor Bank	
of which Microkredit Bank	
Credit Unions (as of June 30, 2011)	123
Pawnshops	48
Insurance Companies	37
of which Life Insurance	2
of which Reinsurance	1
of which Uzbekinvest	
Leasing Companies	46
of which Uzqishloqmash	
Pension Plans	1
of which private	0
Stock Exchanges	1

Sources: Central Bank of Uzbekistan. Uzbekistan Lessors' Association. Information-Rating Agency SAIPRO.

17. There is an underlying lack of confidence in the financial system. This stems from the history of unanticipated policy changes and inconsistent application and interpretation of policies including: (i) difficulties faced by bank customers in withdrawing cash from bank accounts; (ii) a policy environment of state directed lending to underperforming state owned companies crowding out private sector funding availability and market-driven pricing; (iii) weaknesses in the policy environment impacting the effectiveness of reforms, financial products and their delivery capacity and mechanisms; and (iv) requiring banks to perform noncore functions including ensuring customer compliance with foreign exchange regulation, tax enforcement, anti-money laundering compliance, and payment obligations of corporate clients.

18. Among its key services, a financial system allows people to save and borrow. The mobilization of savings can be ascertained through a number of indicators. One is bank deposits as a percentage of GDP, 23.4% at the end of 2011 (Table 3). Another indicator is broad money, which was 23.8% of GDP at the end of 2011.[19]

19. The ratio of credit as a percentage of GDP is a common measure of its provision to the economy, as well as of the depth of the banking system. At the end of 2011 bank credit was 20.1% of GDP, from 17% in 2010. In addition, capital market development as measured by

[18] Source: Central Bank of Uzbekistan, Uzbekistan Lessors' Association, SAIPRO.
[19] International Monetary Fund (IMF) 2012. *Regional Economic Outlook UPDATE. Middle East and Central Asia.* Washington D.C.

equity market capitalization was 9.7% of GDP, indicating that the equity market in Uzbekistan lags several of its regional peers. Private enterprises obtain funding from a range of sources including banks, equity, and bond markets. It appears that neither the banking sector nor the equity markets commensurately support the current pace of economic growth.

Table 3: Financial Market Size and Level of Development 2010 and 2011 (% of GDP)

Country	Broad Money	Money in % of broad money	Credit	Deposits	Bank assets	Equity market capitalization	GDP (current $)
Armenia[a]	29.5	53.0	34.8	20.4	54.1	1.4	10,248
Azerbaijan	22.9	69.2	23.5	12.0	44 0	...	51,700
Georgia[a]	30.6	39.4	33.5	24.4	52.3	8.7	14.4
Kazakhstan[a]	35.7	39.4	32.2	30.7	46.9	43.4	184.5
Kyrgyz Republic	31.0	59.5	13.0	13.0	31.0	1.7	4,600
Tajikistan	18.0	63.7	15.0	12.0	24.0	...	5,600
Uzbekistan[a]	18.9	....	20.1	23.4	35.3	9.7[b]	43,315
Estonia	58.5	54.2	98.6	64.3	135.0	12.1	19,200
Latvia	48.8	57.6	89.6	36.0	172.5	5.2	24,000

Notes:
[a] Data for Armenia, Georgia, Kazakhstan, and Uzbekistan is for 2011. Data for other countries is for 2010.
[b] Consultant's own calculation.
…. = data not available
Sources: IMF, World Bank. National Statistical Service Armenia. IFC. World Economic Outlook. Development Indicators. European Bank for Reconstruction and Development.

1. Bank Performance

20. Eight banks under majority control of the state continue to dominate banking[20] and account for nearly 74.0% of total assets. The National Bank of Uzbekistan is the largest, and wholly state-owned. While the government encourages banks to lend in the mid- to long-term, most deposits and financial products are short-term. High loan-to-deposit ratios, coupled with maturity mismatches between loans and deposits, have presented banks with a liquidity challenge. As of the end of 2011 the banking sector loan portfolio had grown 35.6% to $8.7 billion, accounting for 20.1% of GDP, while total banking sector assets accounted for about 35.0% of GDP. Deposits were about 23.0% of GDP.[21] Although nonperforming loans remain low at 0.7% of total loans,[22] rapid credit expansion has raised some concern about loan quality as well as contingent liabilities. Generally high capital adequacy ratios have also raised questions about the level of efficiency in financial intermediation.

21. Total indebtedness (banks, credit unions, and microfinance organizations) was about 21.0% of GDP in 2011, among the lowest in the region, as was the ratio of credit costs to loans, which fell to below 1.0% in 2011 from 1.2% in 2009.[23] The government provides capital, funding, and business flows to state banks. About 164 insolvent companies, accounting for about 10.0%

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[20] National Bank of Uzbekistan, Asaka, Agro, Promstroybank, Halq bank, Ipoteka, Mikrokredit Bank and Qishloq Qurilish Bank.
[21] Central Bank of Uzbekistan.
[22] IMF 2012. *Regional Economic Outlook UPDATE. Middle East and Central Asia.* Washington D.C
[23] Standard&Poors. April 4, 2011. *Credit Costs are Stabilizing for Banks in Russia, Kazakhstan, Ukraine, Belarus, Azerbaijan, Georgia, and Uzbekistan.* www.standardandpoors.com/ratingsdirect

of total bank assets at the end of 2011, had been repossessed by state banks on government instructions.[24]

Table 4: Banking Sector Development, 2011

	Commercial banks
Total capital ($ million)	2,972
Total assets ($ million)	15,294
Total outstanding loans ($ million)	8,720
Total deposits ($ million)	10,051
Total capital (% of GDP)	6.9
Total assets (% of GDP)	35.3
Total outstanding loans (% of GDP)	20.1
Total deposits (% of GDP)	23.2
Loan to deposit ratio (%)	86.7
Credit expansion (annual increase; %)	35.6
Capital adequacy ratio (IMF)	24.2
Return on assets (%) (IMF)	1.9
Nonperforming loans (% of total loans) (IMF)	0.7

Source: IMF 2012. *Regional Economic Outlook Update. Middle East and Central Asia.* Washington D.C and Central Bank of Uzbekistan

2. Securities

22. Uzbekistan has an underdeveloped securities market, with government and corporate bonds, corporate stocks, the only three financial instruments. Maturities on government bonds remain relatively short-dated and the market is small and not yet well developed. Most government bonds issued have maturities of 2 years while the maturity of corporate bonds ranges from 5 to 10 years. Because of captive investors, nominal yields of government securities are low and real interest rates are negative (that is, yields do not reflect the true status of the real economy).

23. Likewise the corporate bond market remains small and undeveloped. While private companies are the main issuers of corporate bonds at attractive yields, there are few private companies of sufficient size in Uzbekistan to issue such bonds.

24. Government bonds are traded at the currency exchange while corporate bonds are traded via the Interbank Trading System (MTS). However, there have been few trades. The government requires that banks and insurance companies hold a specified percentage of their reserves and assets respectively in government securities. Also the money market is largely undeveloped and the secondary market is thin. In 2011 the total turnover of securities was about $118.7 million (SUM213.1 billion).

25. There are over 1.45 million owners of securities and 1,309 functioning joint stock companies, of which 916 were established on the basis of state-owned enterprises. By the end of 2011 the shares of 100 joint stock companies were listed on the Tashkent Republican Stock

[24] Standard&Poors. April 4, 2011. *Credit Costs are Stabilizing for Banks in Russia, Kazakhstan, Ukraine, Belarus, Azerbaijan, Georgia, and Uzbekistan.* www.standardandpoors.com/ratingsdirect

Exchange (TRSE). Most TRSE-listed companies are privatized state-owned enterprises. In 2011, the securities of 44 listed companies comprised 49.6% of total stock market turnover, a decrease from 61.8% in 2010.

3. Leasing Services

26. The leasing industry in Uzbekistan has expanded rapidly, but remains at an early stage of development, with demand for services exceeding supply. The market is dominated by two leasing companies—Uzqishloqmashlizing (specialized in agricultural equipment leasing) and Uzavtosanoatlizing (specialized in automotive industry leasing)—followed by the two banks, Microkredit Bank and Aloqa Bank. The largest participant is the state-owned Uzqishloqmashlizing, which is largely funded by government programs. Market volume increased from $1 million to $269.6 million (SUM484 billion) during 1996—2011, while the number of companies with leasing products increased from 4 to 85 (46 leasing companies, 21 banks, and 18 other companies). The share of leasing increased from 0.4% of GDP in 2001 to 0.62% of GDP in 2011, and is expected to increase to over 0.9% of GDP by 2015. The structural organization in 2011 was distributed fairly evenly among technological equipment (30.1%), agricultural equipment (30.9%), and motor vehicles (24.8%), with a smaller share to property (14.2%).

Table 5: Development of the Leasing Sector

	2006	2007	2008	2009	2010	2011	2015 (forecast)
Share of leasing services (% of GDP)	0.63	0.76	0.95	0.84	0.7	0.62	0.94

GDP = gross domestic product.
Source: Uzbek Leasing International A.O.

4. Insurance Sector

27. There are currently 34 non-life, two life, and on re-insurance companies. The market is in the early stages of development, with insurance penetration at 0.30% of GDP, while premiums paid in 2011 totaled SUM231.6 billion ($129 million). Major insurance products include compulsory motor insurance, compulsory employers liability, contractors all-risk insurance, property insurance (against pledges and all types of catastrophes), and export credit insurance. The slow penetration of general insurance and negligible growth of life insurance can be attributed to regulatory, social, human development, and cultural factors, as well as the state-dominated market structure. Constraints need to be addressed, including (i) weak competition in the insurance market, where premium discounting is a common practice; (ii) insurance agents' poor knowledge about the products they sell; (iii) an unbalanced relationship between the insured and the insurer, which favors industry profitability but undermines the development of the market; (iv) difficulty in regulating solvency requirements of private insurers; (v) lack of separation between shareholder funds and policyholder funds; and (vi) low per capita income.

5. Pensions

28. Uzbekistan has a two pillar pension system: (i) the pay-as-you-go social security fund, and (ii) a mandatory private pension fund. Individual private retirement savings plans have not been introduced, but there is an element of "pillar three" retirement savings in the mandatory private pension fund, where entrepreneurs can make voluntary contributions into an accumulation fund. The state social security fund is financed on a current (or pay-as-you-go)

basis from general government revenues. It encompasses a range of programs including disability payments, and the state old-age pension.

29. The Accumulation Pension Funds are voluntary pension accounts to which individuals can deposit any amount. One percent of all wages is directed to the Accumulation Fund, with the return dependent on the amount of deposits. Each member of the plan is entitled to receive interest on contributions equal to at least the rate of inflation. Concerns have been raised about how the investment returns as promised under the plan's mandates can be met as the fund grows and because there is likely to be a shortage of suitable investment instruments in which contributions can be invested. There is only one (state-owned) pension fund, with assets under management equivalent to 0.1% of GDP. Accumulation fund resources are not permitted to be invested in corporate securities.[25] In 2011, the return on pension fund investments was about 8%.

6. Credit Rating Agencies

30. Credit rating in Uzbekistan is still at an early stage of development, with three credit rating agencies: Ahbor Rating, Prime Rating Services, and Information-rating agency SAIPRO. There is little information on Prime Rating Services, while SAIPRO was set up in 2006 and has focused mainly on insurance sector analysis.

31. The Uzbekistan Banking Association established Ahbor Rating in 1996 pursuant to the Resolution of the Cabinet of Ministers № 427 from 09.11.1995 to provide rating services to commercial banks, insurance and leasing companies, issuers of corporate bonds, credit unions, micro-credit and other organizations. (See Table 6 for profiles of Ahbor Rating). It is a closed joint stock company, wholly owned by the Uzbekistan Banking Association, raising a possible conflict of interest. Ahbor Rating, which began rating services in 1997, was mainly established to provide infrastructure for future list companies and to invite investors from abroad; it does not rate government enterprises. During 1996–2006, it mainly analyzed banks and insurance companies, and provided consultancy services, among other things, in addition to defining credit rating methodology. Credit ratings services involve commercial banks, insurance companies, and other financial institutions; the debt securities of banks and other financial institutions; bonds and other promissory securities of enterprises in the non-financial sector; and corporate management in financial institutions.

7. Financial Sector Infrastructure

32. Financial sector infrastructure remains underdeveloped and direct government interventions through specialized institutions, subsidized financing programs, and tax incentives have tended to perpetuate the role of the banking sector as a conduit for planned financing rather than performing intermediation between savers and borrowers.

33. In October 2011, Uzbekistan's president signed the law *On Exchange of Credit Information*, providing the legal basis for a unified credit information bureau that collects and provides credit information from and to financial institutions, including banks, microfinance institutions, leasing companies, and insurance companies.[26]

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[25] In 2011, there were only 3 corporate bond issues with volume $39 million outstanding. Based on desk research it is understood that state-owned entities are the dominant investors in both government and corporate bonds.

[26] The law *On Exchange of Credit Information* entered into force on 1 January 2012. Credit unions, however, ceased operations in 2011 under the instruction of the Central Bank of Uzbekistan.

34. There is no unified collateral registry containing information on both movable and immovable collateral made available to all financial institutions, including banks, microfinance institutions, and leasing companies. Delivery mechanisms and products are undeveloped. For example, micro-lending is concentrated in the banking sector; the availability of housing finance has not been adequate for potential need; mobile financial services (mobile payments, transfers and banking) is nascent; insurance, including micro-insurance for the poor, has low penetration; and demand for leasing products remains unmet. The capital market remains marginal and underdeveloped. Capacity constraints include weak financial literacy, especially among women, low income individuals, and the underserved; there is insufficient knowledge and experience to develop and manage financial products, a shortage of experienced and trained personnel for prudential supervision and the regulation of nonbank financial institutions (including microcredit organizations), and undeveloped corporate governance and risk management practices in financial institutions.

C. Business Environment: Access to Financial Services

35. Lack of access to financial resources constrains the development of financial services. Limited financial products are not specifically tailored to the credit and financial coverage needs of micro and small enterprises[27] and other non-state borrowers, impinging on their further development. Credit demand by businesses, especially small businesses, remains unmet. Uzbekistan's micro and small enterprise sector employed 8.9 million and contributed to 50.1% of GDP in 2009. It was estimated that by the end of 2011, the number of micro and small enterprises increased to 246,441 (out of 523,400 registered legal entities) and contributed to 54.0% of GDP.[28] The sector holds considerable potential for further income generating activities given its common borders with five other countries. In 2011, the sector employed 8.9 million people, or 74.8% of people employed, while rural areas absorbed more than 68.0% of nearly one million new jobs created that year.[29]

36. Various indicators assess business and investment climates. Although these indicators have several limitations that need to be taken into account when interpreting the results, their regular monitoring can provide incentive structures for reform priorities. Although only indicative, according to the World Bank's Doing Business 2012 Report, Uzbekistan is ranked 166th among 183 countries on *Getting Credit Criteria*. The World Bank Group's Enterprise Survey shows that 10.48% of all firms in the country have lines of credit or loans from financial institutions, while the regional average is 43.91%. In addition, 8.23% of Uzbek firms are using banks to finance investment, compared to 37.31% in the region. On the ease of doing business and access to formal funding, Uzbekistan is below average compared to other countries in the region. In 2012 government adopted resolution to address these constrains, however, the results have not be evaluated at this point.

[27] The Uzbekistan Banking Association manages a credit information bureau, a commercial registry. Under the current framework, membership in the credit bureau is limited to 13 banks.

[28] Report of the President of Uzbekistan at the Cabinet of Ministers meeting *on the results of socio-economic development of the country in 2011 and major priorities of the economic program for 2012*. Uzbekistan.

[29] In 2011, of a population of about 29.3 million, 11.9 million were employed, 8.9 million of them in the micro, small and medium enterprise sector; 0.6 million (5%) were unemployed. Source: State Statistics Committee, Ministry of Labor and Social Protection; Ministry of Economy. Uzbekistan.

Table 6: Ease of Doing Business, Getting Credit and Index of Economic Freedom Rankings

	Doing Business 2012 Ease of doing business rank out of 183 economies	Doing Business 2012, Getting Credit rank out of 183 economies	Index of Economic Freedom 2012, rank out of 179 economies
Afghanistan	160	150	…
Armenia	55	40	39
Azerbaijan	66	48	91
Georgia	16	8	34
Kazakhstan	47	78	65
Kyrgyz Republic	70	8	88
Pakistan	105	67	122
Tajikistan	147	177	129
Turkmenistan	…	….	168
Uzbekistan	166	159	164

…. = data not available.
Sources: The World Bank: *Doing Business 2012* (http://www.doingbusiness.org) and The Heritage Foundation: *Index of Economic Freedom 2012*. Washington, D.C.

Table 7: Enterprise Survey on Formal Financing

	% of firms with line of credit or loans from financial institutions	% of firms using banks to finance investments	% of firms using banks to finance expenses	Value of collateral needed for a loan (% of the loan amount)	% of firms identifying access to finance as a major constraint
All countries	35.44	25.06	28.53	158.08	30.21
Eastern Europe and Central Asia	43.74	37.18	48.25	133.05	24.14
OECD	…	34.18	35.31	130.22	13.01
Afghanistan (2008)	3.37	1.42	2.47	253.55	36.62
Armenia (2009)	44.25	31.93	…	95.64	32.59
Azerbaijan (2009)	19.87	19.02	…	102.43	23.21
Georgia (2008)	41.76	38.16	…	185.08	35.27
Kazakhstan (2009)	33.24	30.98	…	91.21	30.97
Kyrgyz Republic (2009)	20.35	17.85	…	127.81	27.91
Pakistan (2007)	8.62	9.74	4.64	67.71	17.66
Tajikistan (2008)	33.6	21.42	...	145.22	24.76
Turkmenistan	48.56	13.71	26.44	165.16	15.97
Uzbekistan (2008)	10.48	8.23	...	129.73	25.14

Source: International Finance Corporation and the World Bank. *Enterprise Surveys.* *http://www.enterprisesurveys.org/data/exploreTopics/Finance*. Washington, DC

3. SECTOR PERFORMANCE, PROBLEMS AND OPPORTUNITIES

A. Micro and Small Enterprise Finance

37. In Uzbekistan the terminology for the subsector of small enterprises has recently changed from the traditional differentiation of micro-enterprises and small and medium-sized enterprises (SMEs) to micro- and small enterprises.[30]. The merger in terminology has led to a consolidation in monitoring and statistical evidence. Existing ADB loans to Uzbekistan support micro, small and medium-sized enterprises.[31]

38. There is also a fluid transition between the micro- and SME segments and the missing middle of SMEs has so far benefited most from external lending programs. SMEs are more integrated in the formal sector and therefore it becomes more important to develop and focus on sophisticated financing instruments such as leasing, trade and investment finance including scoring models.

1. Supply of MSE Finance

39. Funds for micro and small enterprises primarily come from (i) traditional commercial banks (focused on higher value transactions), (ii) the specialized Mikrokreditbank (subsidized lending), (iii) microcredit organizations (low-scale transactions);(iv) pawnshops, and (v) until July 2011 credit unions (lower scale transactions). [32]

a. Commercial Banks

40. Commercial banks (30) in Uzbekistan subsume state-owned banks (3), joint stock banks (13) as well as joint venture (JV) banks (5) and private banks (9). State-owned banks still dominate the sector although a few private banks have been able to establish their own niche (currently at 15% of total banking assets) and gain a good reputation among the population as customer friendly and as credible and transparent financial institutions. Commercial banks provide the majority of loans to micro and small enterprises.

41. In 2006, the total MSE loan amount of commercial banks was around $360 million, representing 37.3% of the overall lending portfolio of commercial banks and reaching around 16,000 customers.[33] According to the Central Bank of Uzbekistan, microcredit increased to $419.1 million in 2011.[34]

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[30] According to the government a micro enterprise is an enterprise employing 1–20 people in industry and 1–5 (in some cases 1–10) in services. A small enterprise employs up to 40 in industry, up to 20 in agriculture, 1–10 in construction, and up to 10 in other subsectors. A medium-sized enterprise employs 41–100 people in industry, 21–30 in agriculture, 11–50 in construction, and 11–30 in other subsectors.

[31] Also refer to chapter III ADB sector experience: ADB's Small and Medium Enterprise Development Project was approved on 11 December 2000 for $50 million. Another project for the Small and Micro-finance Development Project was approved on 9 December 2002 for $20 million while the latest Second Small and Micro-finance Development Project was approved on 21 April 2010 for $50 million, which facilitates access to credit by micro and small enterprises across Uzbekistan. On 19 October 2012 Equity Investments in Ipak Yuli Bank was approved for $6 million to contribute to private sector development by helping extend credit to small businesses.

[32] At the end of June 2011, there were 123 active credit unions in Uzbekistan. However, in July 2011, under the instruction of the Central Bank of Uzbekistan, credit unions ceased to accept deposits and extend new loans. Licenses were revoked in some credit unions due to double accounting and/or ponzi-like schemes. Other possible reasons for revoking licenses include a lagging legal and regulatory framework following the rapid development of the credit unions since 2002, and concerns over financial stability as credit expansion had been rapid and credit provided at high lending rates.

[33] ADB 2010 PID Technical Assistance–7523. *Capacity Building for Micro-finance Development*,.

[34] Central Bank of Uzbekistan.

42. According to latest available data, bank loans outstanding as of 31 December 2011 totaled SUM15.6 trillion (about $8.7 billion), of which investment loans were SUM4.4 trillion (about $2.5 billion). Micro and small enterprises borrowed SUM4.0 trillion from banks (about $2.2 billion), which helped create about 291,000 new jobs, while microcredit totaled SUM752.3 billion ($419.1 million). Of this, $143.4 million of loans were borrowed by small businesses on foreign credit lines in US dollar and local currency.[35] The largest bank, the National Bank of Uzbekistan for Foreign Economic Activity, accounted for 28.2% of all commercial bank loans outstanding in 2011, but less than 16.0% of total deposits, reflecting its role as the conduit for various financing programs. For private sector banks, it is mainly Ipak Yuli Bank, Hamkor Bank, and Kapital Bank that cater for the upper end of micro and small enterprise finance. Almost all commercial banks in Uzbekistan are encouraged by the government to undertake micro and small enterprise financing by establishing preferential lending funds with special terms and conditions.

43. The majority of the funds are distributed through the rigid payment and transfer systems of the Uzbek banking system, which under certain circumstances allows cash disbursements for microcredit. Loan size as well as maturities and tenure differ, but are in the range of up to one year, with no grace period.

44. The Central Bank of Uzbekistan supervises and regulates all commercial banks, including state-owned banks.

b. Mikrokredit Bank

45. In 2006, the government established the specialized Mikrokreditbank, which was able to increase the total number of customers in a short period to 140,000 in 2009 and 200,708 in 2011. By end 2011 the number of outstanding loans amounted to SUM391.5 billion ($214 million) of which SUM288.6 billion[36] ($160.8 million) was to small and micro enterprises with SUM160 billion in concessional (microfinance) lending. In 2011, Fitch Ratings rated Mikrokreditbank's outlook B stable.

46. Customers usually include more affluent micro and small enterprises and are expected to hold all of their accounts with the bank. The bank had assets of SUM489billion (about $276.1 million) and 83 branches as of 31 December 2011. Mikrokreditbank also receives donor funds from Sparkassenverb, Germany, the World Bank, and others. The average microfinance size was $5,237 at the end of 2011. Mikrokreditbank has three types of subsidized loan: (i) start-up capital, (ii) micro leasing, and (iii) working capital.[37] Interest rates are very competitive as the bank is mandated by the government to provide concessional lending to micro and small enterprises. This has resulted in interest rates averaging 5% per year which are well below the inflation rate of 7.6% in 2011. Microkreditbank takes various types of collateral, but does not consider future cash-flow.

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[35] Central Bank of Uzbekistan.

[36] As per 31 December 2011, $1.0 = SUM1,795.

[37] As per the Cabinet of Ministers Resolution of 06 May 2006 *On the Establishment of MKB*, it has three types of subsidized loans: (i) loans for start-up capital at 3% per year up to 18 months, from 50 to 200 times minimum wage—including for individuals up to 50 times of minimum wage, for registered entrepreneurs up to 100 times minimum wage, and for farmers up to 200 times minimum wage; (ii) loans for the replenishment of working capital at 6% per year—which is 50% of the central bank rate—up to 500 times of minimum wage for up to 24 months; and (iii) microleasing at 5% up to 2,000 times of minimum wage for up to 24 months.

47. Mikrokredit Bank established 234 “minibanks” and 100 agent offices in areas that had no banks in the past to fulfill its mandate of countrywide coverage. Minibanks serve as small-scale branches to attract new clients and provide a minimum of service, but have very limited daily cash authority.

c. Microcredit Programs

48. The United Nations Development Programme (UNDP) initiated microcredit programs in 1998 through the establishment of three nongovernment organization (NGO) microfinance institutions, reaching 12 in 2005 with initiations and fundings from other donors.

49. Because they developed without a stable and complete legal and regulatory framework, however, in September 2006 the government issued two new laws—*On Micro-finance and On Micro-credit Organizations*—requiring microfinance institutions to re-register as microcredit organizations. This proved to be challenging, because of higher capital requirements of €10,000 to establish microcredit organizations in Uzbekistan’s regions and €20,000 to establish them in Tashkent; and because the procedure first required de-registration as a microfinance institution before re-registration as a microcredit organization, creating time gaps during which the new applications were approved. In addition, many microcredit organizations were donor-funded projects and programs and not registered. Four donor-funded NGO microfinance institutions closed as they did not fulfill the central bank’s new requirements and were also in breach of tax legislation. Nonetheless, since late 2007, new local microcredit organizations have emerged, their numbers reaching 34 by 2011.

50. In December 2011, amendments to central bank regulation (registered by the Ministry of Justice) required that chartered capital at microcredit organizations be increased to €100,000 (from EURO10,000 until 1 January 2012 in rural areas and EURO20,000 until the same date in urban areas). The regulation gave microcredit organizations a 1-year period to implement the new minimum capital until 1 January 2013. It is likely that stakeholders from former credit unions may apply for MCO licenses.

51. At the same time, microcredit organizations have severe funding problems as they cannot take deposits. The initial equity of shareholders and revenues from interest payments are their main source of income, limiting growth potential, and contributing to high interest rates. This inability to grow also impacts financial viability, since there is little room for economies of scale and efficiency gains. Because of these strict cash regime requirements, and lack of appropriate software linking to the respective head offices, microcredit organizations are not allowed to branch out.

52. Microcredit organizations are allowed to receive external funds from donors, but the process is cumbersome due to conflicting regulations. In the typical case of a donor-funded, on-lending program—in which commercial banks receive funds for on-lending to either micro and small enterprise clients or microcredit organizations directly—the fact that banks are not allowed to lend without a purpose leads to direct loans to the clients of the microcredit organizations’, cutting the microcredit organizations out. There is no possibility to extend a standing credit line to microcredit organizations, which they can use on their own risk for their clients. Accepted and approved practice is that when microcredit organizations borrow from banks and on-lend to their clients, banks must open separate loan accounts for each client of a microcredit organization and transfer the amount to their accounts.

53. That microcredit organizations cannot take deposits also limits their ability to participate in mobile financial services. A system based on a mobile phone storage card (“e-

wallet") is currently not possible. In principle mobile financial services can be delivered by two models: bank account based and mobile phone card based. If microcredit organizations want to participate in mobile financial services they need to interact with a mobile phone provider as a proxy for the missing bank account. More details on mobile financial services are in section B.

Table 8: Micro Loans and Micro Deposit Services in Uzbekistan, 2011

Microfinance providers	Legal status	Number	Number of active microfinance borrowers	Total loan portfolio, $, 000	Average loan size, $	Number of depositors	Deposit portfolio, $, '000	Average deposit size, $
Mikrokredit Bank	Bank	1	22,895	213,649	5,237	435,799	63,736	146
Microcredit organization	NBFI	34	15,000	8,914	417.8			
Credit unions (June 2011)	Credit union	123	70,752	175,229	2,477	212,393	139,703	658

NBFI = Non-bank financial institution.
Source: MKB. Central Bank of Uzbekistan and NAMOCU (All credit unions were liquidated by the end of 2011).

54. As of the end of 2011, the average loan size of microcredit organizations was substantially smaller (about $420) than banks and credit unions, with total loans of just over $8.9 million. This partly reflects their limited capital base, but also their outreach to very small enterprises and private households. At the end of 2011, they served almost 15,000 active clients. This represents a very small market share compared to the credit unions. However, the growth rate and outreach of microcredit organizations are greater than that of banks. According to the National Association of Micro-finance Organizations and Credit Unions (NAMOCU), microcredit organizations satisfied only a very small portion of market demand in 2009.

55. The *Law on Micro-Finance*, approved in September 2006, quantifies

- microcredit as 1,000 times the minimum wage (from 1 January 2011 to 1 August 2012 pegged at SUM62,920), which is equal to $35,053 which is disbursed in non-cash form;
- micro loans as 100 times the minimum wage, which is equal to $3,505.3 in cash and non-cash disbursement;
- micro-leasing as 2,000 times the minimum wage, equal to $70,106 non-cash disbursement.

Table 9: Microcredit Organizations' Terms and Conditions, 2011

	Maximum loan amount	Monthly interest rate (%)[1]	Maturity (years)	Conditionality	Repayment
Micro loan	$3,505	5–6	1	Cash,	In cash
Microcredit	$35,053	5	1–1.5	Non-cash	In cash and non-cash
Consumer loan	…	5	1	Non-cash, must be a locally produced product and paid directly to the beneficiary	In cash and non-cash
Micro leasing	$70,106	6	2	Non-cash	In cash and non-cash

… = data not available
Source: First column: Microfinance law, others consultants' own estimates and interviews.

56. The interest rates charged per month are higher in the nonbanking sector in comparison to commercial bank lending: 6.0% by microcredit organizations and the subsidized 1.2%–2.0% by Mikrokredit Bank for credits targeting the MSE sector[38]. Microfinance clients prefer the nonbanking credit services due to its immediate access to cash, availability and faster speed.

57. Many small scale clients need loans to overcome short-term liquidity problems and to pay smaller bills. Hence cash is needed. However, due to stringent regulations, cash loans can only be provided when disbursing microloans. Re-labeling loans to better meet the demand for cash loans, may increase the risk of the microcredit organization sector experiencing similar difficulties as that experienced by the closure of credit unions in 2011. The relatively small market share of microcredit organizations, however, does not pose a risk to financial stability.

58. The services provided by microcredit organizations are limited to the above mentioned loan types not only by regulation but also by microcredit organizations' staff capacity. There is a general shortage of trained staff, both in regards to managerial skills as well as in financial and advisory services, especially in remote and rural areas. Some of the microcredit organizations are small with staff having to perform a number of functions within the organization. This is linked to the uneven regional distribution of microcredit organizations, most of which are in Tashkent city or in Tashkent region, and larger cities such as Bukhara or more affluent regions such as the Fergana valley.

59. Despite the government's efforts to support micro and small enterprises, numerous surveys and assessments indicate that access to credit is a larger obstacle for businesses than high borrowing rates. This was confirmed by the former rapid growth in credit unions and microcredit organizations lending despite interest rates far in excess of those charged under various policy lending programs through state-owned banks. The small private banks with less access to government funding, charge relatively higher rates than state banks, but are still significantly cheaper than credit unions rate in the past.

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[38] Commercial bank interest rates to different market segments are between 14%–18% per year

60. Microcredit organizations are also under the supervision of the Central Bank of Uzbekistan. They need to prepare and submit monthly balance sheet and income statements and a yearly social performance report, showing their role in remote areas.

d. Pawnshops

61. Pawn shops began operating in 2004 and as of end 2011 have 48 outlets. Their number and activities are increasing but they are not significant providers of micro-credit and are more focused on emergency and consumer loans with about 16% monthly interest rates. There is anecdotal evidence of informal moneylenders providing short-term credit at very high rates (e.g. 200% per year) but no estimates of volume are available. People who have no or limited knowledge of formal institutions and lack trust in these institutions apply for such loans.

Box 1: Credit Unions

Credit unions were developed in 2002 with assistance from the ADB, USAID and the World Council of Credit Unions, they also supported the legal and regulatory framework. Credit unions grew quickly to 123 by the end of May 2011 and became significant players in the still vastly underserved lower-end market for loans to individuals and micro and small enterprises. Credit unions are regulated and supervised by the Central Bank of Uzbekistan.

In the second and third quarters of 2011 the central bank had revoked licenses in several credit unions and ordered all other credit unions to close (self-liquidate) to avoid their license being revoked. The reason given was the misconduct of a few credit unions that used Ponzi schemes, double book keeping and a too free interpretation of not clearly regulated loan provisions.

Credit unions, unlike banks, had relied on their members to wholly fund the lending operations through shares and deposits. Credit unions mainly concentrated on urban areas with a focus on the larger micro and small enterprises. As of 30 June 2011, the number of credit union members reached 244,678 of which 242,234 (99%) were individuals and individual entrepreneurs. The volume of assets of credit unions amounted to SUM395.8 billion ($230.9 million) and loan portfolio reached SUM303.4 billion ($177 million). The volume of attracted deposits in credit unions of Uzbekistan in the first half of 2011 was SUM256.3 billion ($149.5 million) of which SUM240 billion ($140 million) were from deposits of individuals and individual entrepreneurs.

As of 30 June 2011, credit unions had about 70,000 loans outstanding with an average size of almost $2,500 and a total loan portfolio exceeding $175 million. The bulk of these loans were provided to entrepreneurs and micro-enterprises, largely for trading activities. Because of their funding through deposits and other external funds, their growth has been stable and some more developed credit unions was also migrating from micro to small enterprise financiers. There is additional demand in the agricultural sector, notwithstanding government's targeted financing programs, illustrated by the fact that about 10% of credit unions loans were advanced for agricultural purposes. The most developed credit unions established the Credit Union Association in 2005, which expanded members and partners to support the successful credit union movement in Uzbekistan. Association also established credit guarantee scheme (Alyants Garant) for its members to manage liquidity. Despite higher interest rates, micro enterprises preferred credit union because of their cash disbursements and higher flexibility in providing loans.[39]

It is expected that some former stakeholders of credit unions will apply for licenses to operate microcredit organizations and some of the clients will apply for loans with commercial banks and existing microcredit organizations.

[39] All legal entities, including banks, are obliged to make transactions by wire transfer, except limited/allowed transactions in cash. Bank lending is mainly in non-cash, while for credit unions and microfinance organizations, lending is mainly in cash.

2. Demand for Micro and Small Enterprise Finance

62. In 2006 there are at least 2.8 million entrepreneurs, 253,300 micro, and 15,300 small enterprises in Uzbekistan. If for example 25% of those required a loan of $1,000 it would result in a credit demand of $767 million. According to a 2007 World Bank study,[40] demand for microfinance services comes to $500 million, and only 7.8% of business financing is covered by loans—the lowest percentage in the region where the average is 23.3%. There is large unmet demand for loans and banking services that is not covered by the banking and nonbanking system, even though the importance of micro and small enterprises for the economy is undeniable; their contribution to GDP increased substantially from 30.0% in 2000 to 50.0% in 2009, 52.5% in 2010, and 54.0% in 2011.

63. Micro and small enterprises are mostly active in the service (retail and catering) and agriculture sectors, with a small portion active in industry, construction and transport. In foreign trade, the small business share was below 10.0% in 2007–2008 and only 4.7% of small businesses participated in foreign trade activities. In 2011, the share of small business reached 18.8% in total exports. About 80.0% of the agricultural sector's contribution to GDP is accounted for by small-scale entrepreneurship, suggesting that a significant portion of the 160,000 farms and *dekhan* farms[41] are potential small and microfinance borrowers. Considering individual, small, and micro-enterprises and small-scale agriculture, the total number of potential borrowers is conservatively in the range of 800,000. With fewer than 300,000 borrowers currently served, there is clearly enormous unmet demand for small and micro-credit.

64. In addition to the contribution to GDP, micro and small enterprises play a large role in employment absorption. According to Government statement annual demand for labor (as measured by amount of jobs created) is estimated at about 900,000 people. In 2011, of Uzbekistan's estimated 29.3 million people, 11.9 million were employed, 8.9 million of them in micro and small enterprises; 0.6 million were (officially) unemployed.[42] Alongside Uzbekistan's demographic trends, with 450,000 to 500,000 graduates per year joining the labor market, this underscores the importance of micro and small enterprises and their need for finance.

65. A welfare improvement strategy (WIS) implemented during 2007–2010 provided the strategic framework for the government's efforts to reduce poverty and improve welfare. This included the introduction of nonconventional employment opportunities (cottage industries, development of private farms, and family businesses) for the creation of new employment opportunities. During the period 2005 to 2010 more than 3.8 million new jobs were created during this period, with almost 1 million created in 2010 only, according to official statistics of the State Statistical Committee. An increasing number of jobs were created in the social sectors, indicating the potential of the services sector to generate employment opportunities. The industry sector also generated jobs in this period, while there was some retrenchment of jobs in the agriculture sector.

66. Population pressures will exceed those in most other former Soviet republics. Indeed, five of the eight most densely populated regions of the CIS—Andijan, Fergana, Tashkent, Namangan, and Khorezm—are in Uzbekistan, and populations continue to grow rapidly in all five, compounding the pressure on micro and small enterprises to create employment. The need for financial services becomes more pressing when considering the large number of migrant

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40 World Bank. March 2007. *Microfinance Development in Uzbekistan, Technical Note* Washington D.C.

41 A small-scale family business involved in production and sale of agricultural products in its own backyard.

42 Additionally, an independent study estimated that the contribution of the informal economy to GDP was around 35% and accounted in 2005 for half of the workforce.

workers sending money home. Formal estimates of remittances to Uzbekistan from the Russian Federation alone were about $4.9 billion in 2011, or about 11.0% of the country's GDP at the official exchange rate. Informal estimates and remittances from all other countries may bring total remittances to about $7 billion, or about 16.0% of GDP.

67. Remittances, mainly from the Russian Federation and Kazakhstan, have begun to grow again after the financial crisis. As in many other countries, remittances usually provide additional income to the lower-income population. The prospects for higher earnings elsewhere also encourage especially poor people to go abroad. Money is remitted through various official and unofficial channels and is mainly used for consumption.

68. As in many other countries, financial literacy is generally weak; there is little knowledge of how to efficiently allocate financial resources to their most productive uses and to channel resources to entrepreneurial or investment projects with high expected rates of return. According to the World Bank[43] financial literacy is: *"the combination of consumers'/investors' understanding of financial products and concepts and their ability and confidence to appreciate financial risks and opportunities, to make informed choices, to know where to go for help, and to take other effective actions to improve their financial well-being."* The poor are often hardest hit in times of financial crisis. Better financial education is therefore needed to empower micro and small enterprises and the poor.

69. Gender equality is also a government concern, even though it is stipulated in the basic laws—2004's *Additional Measures to support the* Activities *of the Women's Committee of Uzbekistan* and a resolution *On Ensuring the Implementation of the Presidential Decree*. As in many other countries, in rural areas women make up the bulk of microcredit borrowers. Some microcredit organizations serve only female borrowers in Uzbekistan's Fergana valley[44], which followed the *Barakot* microfinance program implemented by Mercy Corps in 2001–2006. Hamkor Bank, Ipak Yuli Bank and Agrobank, all of which are participating commercial banks in the ADB Second Small and Microfinance Development Project, have seen the number of microfinance loan accounts opened by women increase during the implementation of the program from 35% mid-2010 to 37% mid 2012. Further analysis is needed to assess the impact any additional micro-credit support would have on women.

3. Government Support

70. The government supports banking and nonbanking activities for micro and small enterprises through a number of legal and regulatory frameworks. The most recent and important is Presidential Resolution No. 1438 of November 2010—*On Priority Areas for Further Reforms and Sustainability Improvement of Country's Finance and Banking System in 2011–2015 and Achieving High International Ratings.* The resolution elaborated and approved a program on priority directions for further reforming and increasing the sustainability of banking and financial systems in 2011–2015. This includes two comprehensive programs and measures: one for the banking system and the other for the further development of microfinance development and nonbank financial institutions in 2011–1015. It specifically includes the extension of nonbanking credit organization networks and the range of services.[45]

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43 World Bank. February 2009. *The Case for Financial Literacy in Developing Countries*. Washington D.C.

44 Fergana valley of Uzbekistan includes Andijan, Namangan and Fergana regions

45 "*Measures aimed at development of microfinance and nonbank financial sector in the country for 2011-2015*.

4. Microfinance and Renewable Energy

71. Microfinance and new technology to enable the efficient use of renewable energy can be seen from two perspectives:

1. It can enable micro and small enterprises to save power costs and receive uninterrupted power supply from renewable energy sources by providing microloans for small–scale, renewable energy sources (mainly solar panels). Experience from other countries shows that microloans for small–scale, renewable energy sources can help micro and small enterprises to extend their fields of business and lead better lives and the additional income can enable them to repay loans. Rural and remote areas experience power outages, which prevent the supply of sufficient energy for performing private and business activities. Yet the concept of specialized credit has not been developed in Uzbekistan and banks have not set up credit lines dedicated to micro and small entrepreneurs willing to invest in renewable energy sources.

2. In general, the introduction of renewable energy in remote areas has in some countries also been used to facilitate mobile financial services. A good example is eCare in Ghana. “The project is helping small entrepreneurs establish rural business centers that sell voice telephony, internet connectivity and clean energy products and services to rural and peri-urban customers. Deployment of the rural business centers is being done through a franchising mechanism managed by Ghana Telecom, the main telecommunications service provider in Ghana. Each rural business center is equipped with a basic business package comprising 3 telephones, a computer, printer, internet services and solar photovoltaic system for power”[46]. A similar project could be set up in Uzbekistan since small solar panels are a case in point in Uzbekistan with its abundance of 290 days sunshine.

72. The move to use microfinance to encourage the introduction of renewable energy is a timely one. In August 2011, the government instructed the state-owned Uzbekenergo to develop a national concept for renewable energy use. Although resources are estimated to last for 20–30 years, the government is eager to learn from examples in other countries.

73. According to the Centre for Economic Research (CER) of Uzbekistan, the potential of renewable energy in the country is about 51 billion tons of oil equivalent with technical capacity at 179 82.3 million tons of oil equivalent. It includes the potential of solar energy in the country where there over 290 days of sunshine a year and is about 50.973 million tons of oil equivalent. Currently oil and gas accounts for 97% of primary energy resources, 2.3% coal, 0.7% hydropower. The share of renewable energy in Uzbekistan does not exceed 1% of total electricity production. Among projects designed to encourage sustainable energy in Uzbekistan, ADB launched the Solar Energy Project in late 2011, with two technical assistance projects: the Solar Energy Development Project and the Design and Strengthening of the Solar Energy Institute.

5. Conclusions

74. While the micro and small enterprise sector in Uzbekistan is characterized by both strong demand for easy access to loans and banking services as well as for more cash-based

[46] Source: World Clean Energy Awards. http://www.cleanenergyawards.com/top-navigation/nominees-projects/nominee-detail/project/76/?cHash=8a575406d0

transactions, there are a number of policy, institutional and capacity constraints that limit the development of the sector and its outreach to remote and rural areas. These include

- state dominance in the banking sector, including government subsidized financial support;
- policy changes and inconsistent application and interpretation of policies;
- overregulated sector and inconsistent regulations;
- legal and regulatory framework limits the development of mobile financial services,
- limited access to external finance limits microcredit organizations' expansion capacity and loan portfolio size;
- limited access to cash;
- financial literacy of typical microfinance clients is low;
- loan products in microfinance, including for renewable energy projects, do not adequately meet the demands of the urban and rural poor population;
- there is a lack of sufficient reliable data; and
- lack of confidence in the banking sector.

B. Electronic Payment Systems

1. Background

75. The central bank defines electronic payments as the implementation of cashless payments by electronic payment instruments, using technical means, using information technology and information systems services.[47] Within Uzbekistan, the government sees electronic payments as a pillar of the payment system, indeed, of the whole financial system. As such, laws and regulations provide significant support, all to promote the use of electronic payments channels as an alternative to cash-based transactions.

76. Current electronic payments by individuals are mainly restricted to plastic debit cards, which are used for payments via a network of point of sale terminals throughout the country. While uptake of these card based systems has been considerable over the last 10 years, there is still large scope for improving accessibility and the usability of electronic payment systems. One way in which this is being realized is via the introduction of mobile based payment systems which can operate independently of card channels and as such have a larger potential for uptake by the population. Launching of these services is still in the early stages but do offer a lot of potential.

2. Supply of Electronic Payment Systems

77. Electronic Payment services available in Uzbekistan can be classified according to the type of services, including: (i) remote bank account management, (ii) payments for goods and services, (iii) person-to-person remittances, (iv) government-to-person remittances, and (v) business to business. (Table 10)

78. Electronic payment systems in Uzbekistan trace back to 2004 when the government introduced the Cabinet of Ministers' Resolution—*On measures for further development of the settlement system based on plastic cards*—to promote the installation of ATMs and the use of debit cards. The motivation to shift to electronic payments included both a desire to reduce, and potentially gain more control over, cash circulation in the country. Additionally promotion of electronic payments would encourage more funds to flow through the formal financial sector, where tax and inflation could be better managed. In April 2010, the president signed another significant document—PP #1325 *On additional measures to stimulate the development of settlement system using bank debit cards*.

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[47] Central Bank of Uzbekistan, http://cbu.uz/ru/payment_system/legal_documents.htm, *Central Bank Regulation # 60 as of 12.01.2002*

Table 10: Availability of e-banking services in Uzbekistan, 2011

Type of service	Availability
Remote bank account management	• SMS banking, particularly for transaction alerts • internet banking (basic information based functionality) • Info kiosks for card based payments to bank accounts • Limited ATM network for cash out services
Payments for goods/services (person to business or person to government for state owned utility)	• Point of sale at Paynet agents used for utility payments • Point of sale at merchants • Bank Kiosks for card payments • Mobile payment terminals used by utility company (door-to-door payments which accept card and cash payments) • Smart Vista Cabinet (online card platform) • M-payments from SMS To'lov
Person to Person (P2P) remittances	• None available as demand is for physical cash
government-to-person payments	• Salary payments for employees of the state and private sector via debit cards • Pension and social payments via debit cards (50% cash/50% card)
business to business	• Almost 100% wire transfer

a. Card Based Systems

79. Electronic payments have so far largely centered on the use of plastic debit cards, which are available either as a Duet brand card issued by the Central Republic Processing Centre, or an international card such as Visa, issued by some banks, such as UzPromStroyBank (UzPSB). The center introduced the Duet card envisioning a unified card platform for all ATMs and points of sale in the country. All banks in the country currently use Duet cards and the associated processing services of the Central Republic Processing Centre, with the exception of UzPromoStroyBank, which maintains its own processing center for the Visa debit cards they issue.

80. The government's support for payments via plastic cards has seen card volumes increase steadily in the last decade, with circulation reaching 8.2 million cards by January 2012, up from just over 31,000 in 1999.[48] Yet, while subscriptions of card accounts have grown, limitations in the current system constrain the usability of the cards and, hence, the volume of transactions in this channel. This includes that, until Jan 2012, plastic cards have been fully independent of other bank accounts with no real time integration between the card and other savings/current accounts. The Central Republic Processing Centre's upgrading of its processing platform to Smart Vista, a global leader in card processing systems, is resolving this issue. The upgrade, which started at the beginning of 2012, will not only provide options for fully integrated online card accounts, but also simplified processes between agent and customers, online point-

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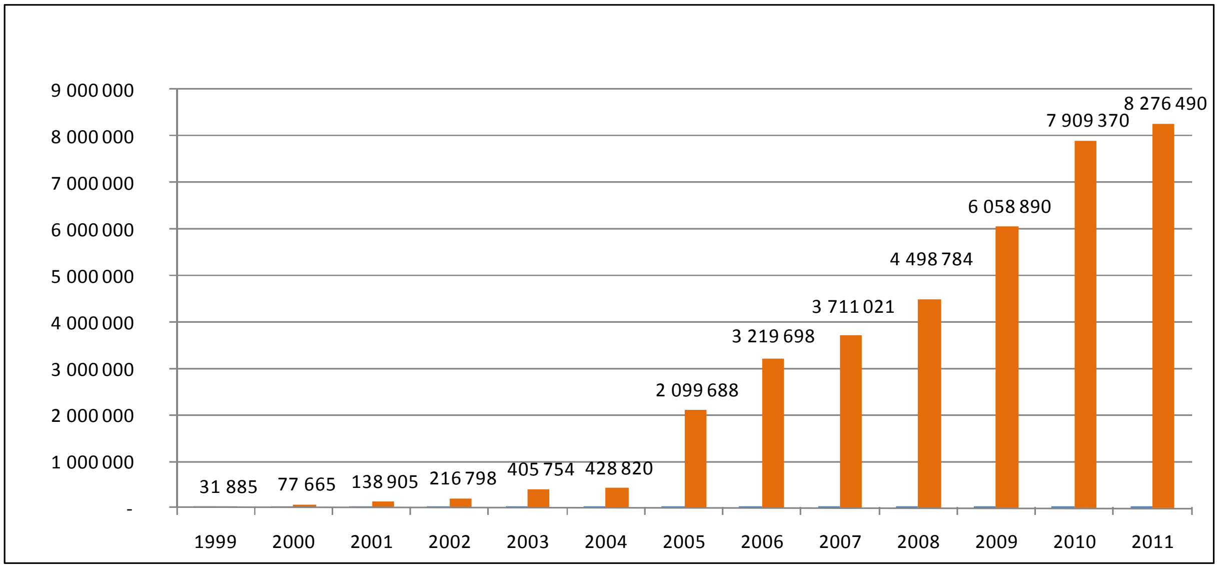
[48] Central Bank of Uzbekistan, *Interbank payment system with the use of plastic card,* http://cbu.uz/ru/payment_system/Indicators.htm. The state is advising (enforcing) both the public and private sector to pay salaries to bank account/debit card accounts. Majority state-owned companies' employees in Tashkent are already receiving 100% of their salary payments in their bank accounts, which later will be transferred (loaded) onto debit card accounts to use for payments

of-sale operations and the option to use the Masspay platform whereby card holders can manage their accounts online with options to process payments directly from their card account.

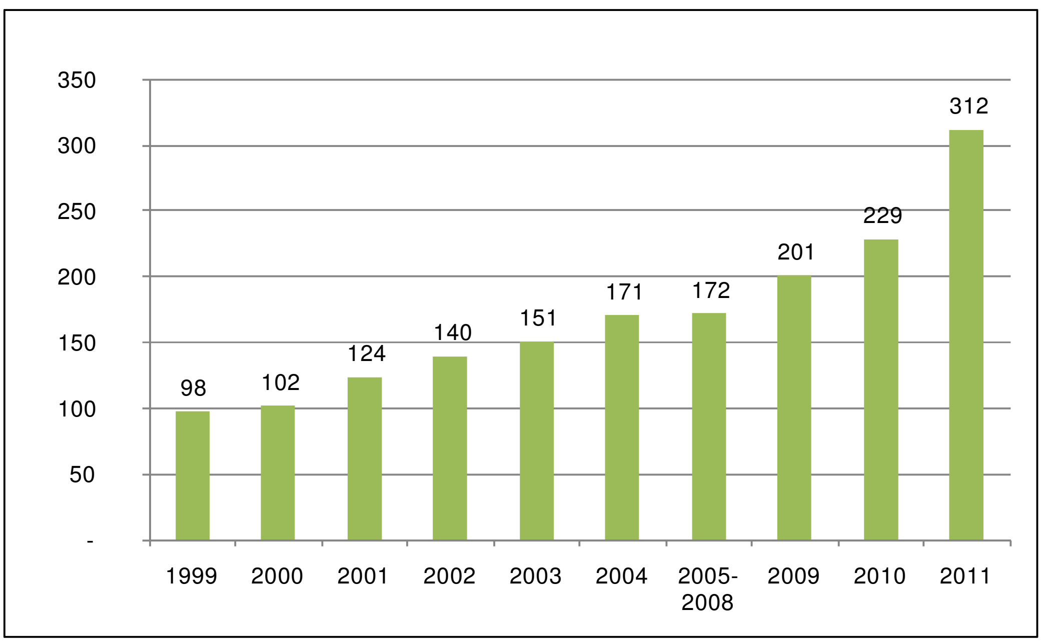
Figure 1: Emitted Plastic/Debit Cards in Circulation as of 01 January 2012



Source: Central Bank of Uzbekistan- Payment Systems Indicators http://cbu.uz/uz/payment_system/Indicators.htm

81. Within the payment infrastructure available in Uzbekistan, plastic cards are typically used either at ATMs, bank kiosks, or points of sale. Of these, ATMs are the least available channel, which is largely attributed to the high costs of servicing ATMs due to the low denominations of local currency. Most ATMs are therefore used only for foreign exchange and targeted more to foreigners wishing to obtain cash. This is perhaps the biggest difference between the electronic payment system in Uzbekistan and other countries, in that ATM volumes typically increases proportionally with card circulation.

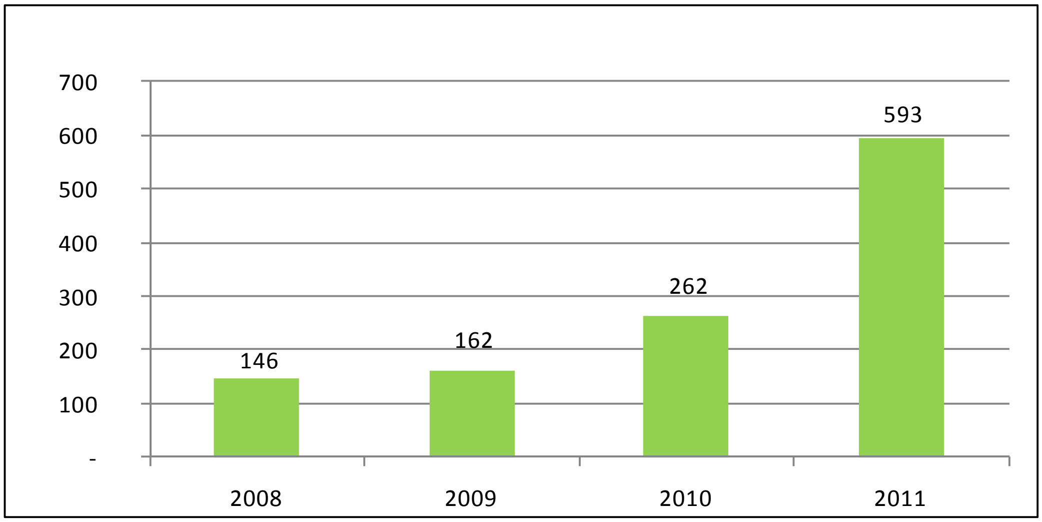
Figure 2: Number of Installed ATMs as of 01 January 2012



Source: Central Bank of Uzbekistan. *Payment Systems Indicators.* *http://cbu.uz/uz/payment_system/Indicators.htm*

82. The second most popular use of plastic cards is at bank operated kiosks, which are used to make card-based payments to service providers, including utilities and mobile companies, to repay loans, and deposit to existing accounts. These kiosks are traditionally located within the banking branches, although some banks have also made them available beyond their banking halls in supermarkets and other key locations. The machines are designed to provide a self-service terminal that accepts debit cards as the mode of identification and payment. While several banks offer these payment terminals to their clients, including Asaka and PromStroyBank, the number of terminals remains small with only 593 in use across the country. It is however anticipated that the shift to Smart Vista by the Central Republic Processing Centre will provide a better platform for the use of these services, and as a result see more banks adopt this electronic payment option.

Figure 3: Number of Installed Infokiosks as of 01 January 2012



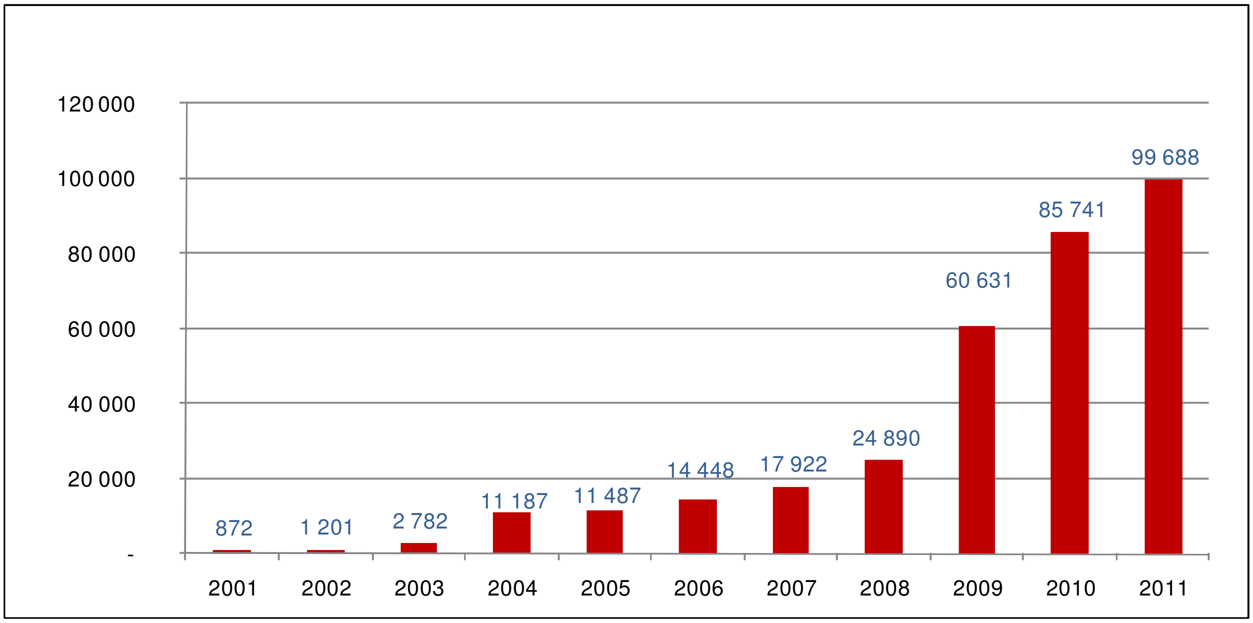
Source: Central Bank of Uzbekistan. *Payment Systems Indicators*
http://cbu.uz/uz/payment_system/Indicators.htm

83. While ATMs and Infokiosks have limited impact on the volume of electronic payments in Uzbekistan, payments via point-of-sale devices represent a much larger percentage of the electronic payments market. About 100,000 devices are in use across the country and located at gas stations, supermarkets, traditional bazaars, restaurants and other merchant sites. One quarter of all points of sale are operated by Paynet, the only payment service provider and, as such, authorized by the central bank to process cash and card payments on behalf of service providers such as utilities and mobile phone companies. The company operates through a network of 25,000 agents who receive payments on behalf of 70 service providers. Although Paynet offers both cash and card-based payments, cash transactions are still most common, accounting for over 70% of all transactions. Despite the wide range of service providers Paynet represents, payments to mobile operators account for 90% of transactions.

84. While most points of sale are owned either by a merchant or Paynet agent, some banks, such as Mortgage Bank, have launched their own networks of mobile terminals providing the same function as a point of sale, although tailored specifically for utility payments. These are

operated by bank staff working in mobile offices and allow for card-based payments of utilities. In the initial year of launch, terminals jumped from 315 to 815.[49]

Figure 4: Installed Points of Sale as of 01 January 2012



Source: Central Bank of Uzbekistan. *Payment Systems Indicators* http://cbu.uz/uz/payment_system/Indicators.htm

b. Mobile Payments

85. Mobile Payments are typically seen as a subset of the larger area of mobile financial services, which embraces mobile banking, mobile transfers, and mobile payments. The experience in several countries, including Kenya, the Philippines and Afghanistan, has proven the potential for mobile phones to transform payment systems. With estimated penetration rates at 85% in Uzbekistan, mobile phones are an obvious choice for launching a payment platform.[50] The government has recognized this potential, supporting mobile financial services in November 2010 with a presidential decree applying over the next five years.[51]

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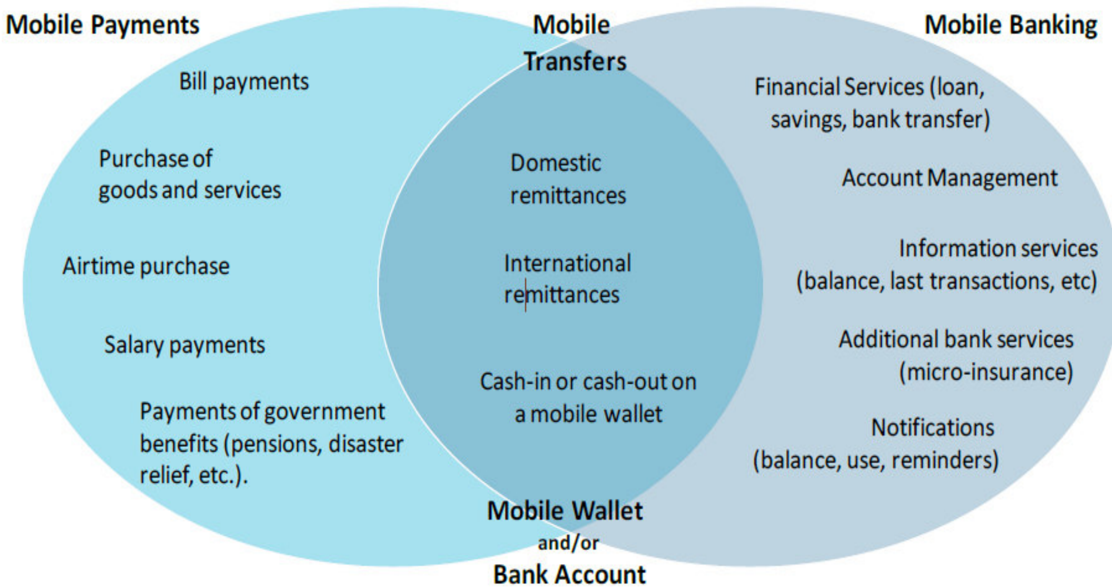
[49] Uzbekistan National News Agency, 16.06. 2011. *Alesya Voyakina. Advantages of the electronic wallet.* http://uza.uz/ru/business/15265/

[50] Olam.uz, 2011. *What Accounts for Higher Mobile Prices?* http://news.olam.uz/press/6679.html

[51] Presidential Resolution # 1438—*On priority areas for further reforms and sustainable improvement of country's finance and banking system in 2011-2015 and achieving high international ratings*—dated 26 November 2010.

Figure 5: Mobile Financial Services

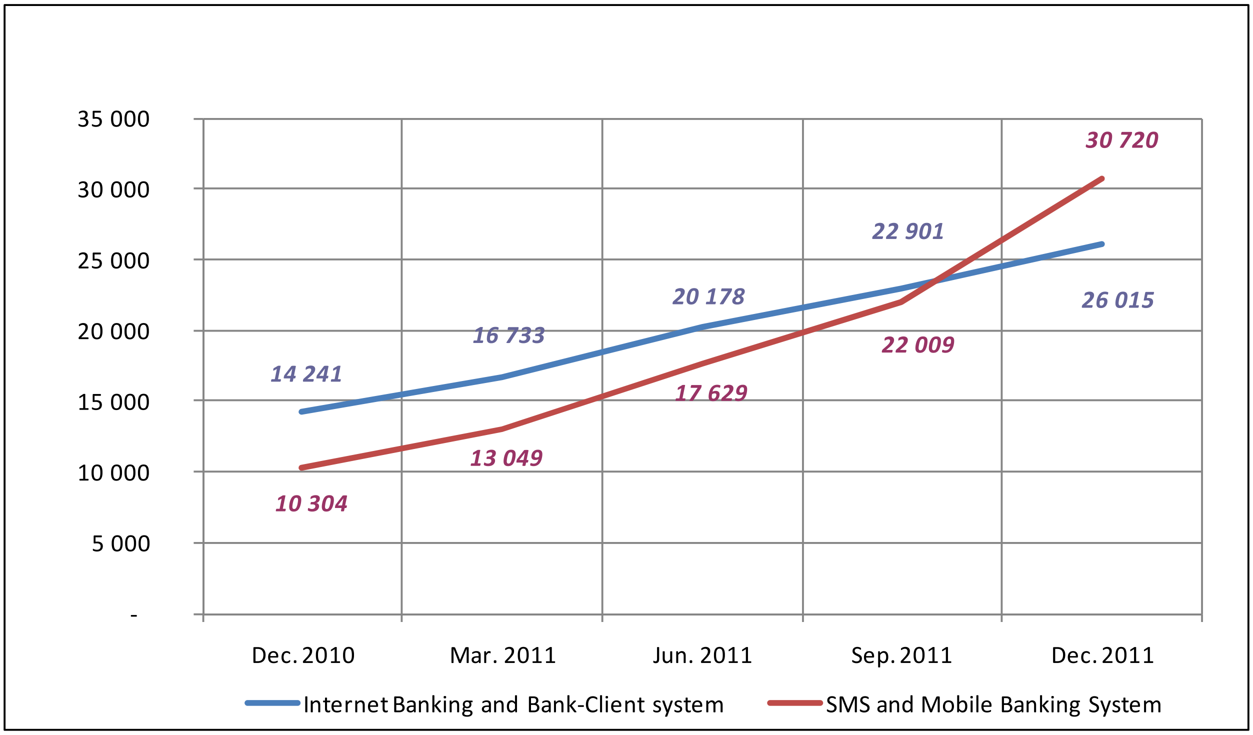


Source: 2012. Mobile Financial Services: the microfinance perspective. PHB Development: Brief 2 March 2012. http://www.phbdevelopment.com/images/stories/downloads/phb%20brief%202_march%202012_mmoney%20models%20for%20mfis_final.pdf

86. Mobile payment systems can be classed according to the provider of the service, which is typically either a bank, an Mobile Network Operator or a third party provider. Within the first category, in which financial institutions offer clients services through a mobile channel, services have traditionally focused on the use of SMS for exchanging information between the bank and clients. A number of banks use this (such as UZPromStroyBank, Ipak Yuli Bank, and Halq Bank), and texts range from alerts regarding transactions on card accounts, to user driven requests for balances and mini statements. Current Central Bank of Uzbekistan statistics report 30,720 users of such services, although this is a combined number for both SMS and mobile banking. While this service is useful, it does not typically extend to mobile-based payments, although some initiatives are being launched to introduce this as an additional service. One such is Ipak Yuli Bank's, which will introduce a mobile-based payment option, although this would require an internet connection on the user's mobile and could therefore be considered more of an internet-based service than a mobile one. Open Joint Stock Commercial Bank Hi-Tech Bank has also launched mobile banking applications to enable the purchase of airtime from mobile operators and bill payments for utilities and internet service provides. These two solutions are focused only on the use of Android phones and hence exclude users of other mobiles, which may in time limit the uptake of the service.[52]

[52] OJSCB Samarkand Bank Website. *https://samonline.uz/saminfo/index.php. Remote Services/Mobile Banking.*

Figure 6: Customers Using Distance Banking Services by Service Type (as of 01 January 2012)



Blue line is for internet banking and type bank-client; red line is for SMS and mobile banking.
Source: Central Bank of Uzbekistan. *Payment Systems Indicators.* http://cbu.uz/uz/payment_system/Indicators.htm

87. The second model of mobile payments involves mobile wallet services launched directly by the Mobile Network Operators (MNOs). This model is not found in Uzbekistan for several reasons, but primarily because regulations prevent operators from using phone credit for anything but airtime, restricting the use of these funds as a mode of payment. Aside from regulations, Uzbek MNO's do not maintain a large network of agents, but instead sell airtime through other providers, such as Paynet. This lack of an agent network is a large barrier to launching a mobile payment service since typically these same agents provide cash in/out services for the mobile payment system. So while MNOs are not directly involved in the provision of mobile payment systems, they do provide all of the supporting infrastructure and service for other providers to extend these services and thereby play a critical role in the overall provision of mobile payment systems in the country.

88. The last model of mobile payment provision involves services offered by third party companies that offer payment services via mobile phones. Two such services are available in Uzbekistan, although only one, SMS Tolov, is live at present. The Chamber of Commerce and Industry of Uzbekistan launched this service in September 2011; it offers mobile-based payments through a direct link between a bank account and a range of service providers. Although the service is still in its early days, it has managed to partner with nine banks and all of the major service providers, offering payments at costs lower than card-based systems. The aim is to scale up the service and target the card market with a cheaper and more convenient mode of payment. While their current offering is restricted to person-to-business payments, they also have intentions to introduce business-to-business payment services, embracing the potential of electronic signatures and documentation.

89. The second player in the third party mobile payment space is UZ Money, a service provided by Halq Bank. A partnership with Paynet is under consideration. The design is based on an electronic wallet that can be topped up either through Paynet agents or participating banks. Funds in the e-wallet account could then be used for making payments to partner merchant or service providers. Cash out would be through the banks only and would return funds to the source account rather than disbursing cash directly. However, the launch has been put on hold due to organizational reasons and technical problems. Meanwhile, UZ Money is working on the implementation of Unstructured Supplementary Service Data (USSD) banking. There is a greater need to pay monthly utility, mobile, internet, and other service bills, as well as taking into consideration the development of modern information and communications technology (ICT) for everyday use, UZ Money offers to implement USSD banking. The holder of a plastic/debit card—the subscriber to USSD banking—can with simple commands from his mobile phone of any brand and configuration pay bills for services and accounts.

c. Internet-Based Systems

90. Internet-based services are another option for electronic payments in Uzbekistan. While overall internet penetration is still relatively low at above 30%, the use of mobile internet services is quite high, with 4.9 million of the 8.8 million internet users accessing internet with their mobile phones.[53] The potential for internet access to rise in correlation to mobile phone usage is therefore strong, which could make internet-banking channels more accessible.

91. Several commercial banks now offer some type of internet Banking service, although most appear to focus on information rather than access to payments online. For example PromStroyBank offers only account information and submission of documents, but not yet online payments. Perhaps as a result, uptake of these services remains limited, with the most recent statistics showing only 26,015 users of internet banking.

92. Electronic wallets and e-payment solutions offered by third party service providers are another mode of internet-based payment systems, but none yet exist in Uzbekistan; services of this nature did exist before, but they exited the market following the introduction of new regulations in mid-2006 that made it difficult for players to remain in the market.[54] Players included WebMoney, Multisoft Solutions, Mobile Link Services, Unipay, E-Pay, and Superkassa, all of whom offered some mode of payment service, but exited because they could not meet the new regulations.

3. Demand for Non-cash Payment Systems

93. Demand for electronic payment systems can be inferred from the current accessibility rates to each of the delivery channel options (Table 11).

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[53] According to the UZB Agency for Communication and Information; some 8.8 million users out of the 29.3 million population. Olam News Portal. 2011. http://news.olam.uz/press/6679.html

[54] These included increasing their licensing requirements to 4 billion($2.2 million) UZS as a capital requirement for any provider, requiring partial state ownership, and other operational limitations including a minimum of 15,000 points of sale.

Table 11: E-payment Delivery Channels and Penetration

Delivery channel	Number available	% of population	Number of devices per million people
Debit cards	8,276,490	28.056	…
Points of sale	99,688	0.338	3,379.25
Mobile/sms	30,720	0.104	1,041.36
Internet	26,015	0.088	881.86
Infokiosks	593	0.002	20.10
ATM	312	0.001	10.58

…. = data not available
Source: Central Bank of Uzbekistan. *Payment Systems Indicators* .*http://cbu.uz/uz/payment_system/Indicators.htm*

94. Currently, 72% of the population (more than 21 million people) is without access to debit cards, making cash their only payment option. This represents a large opportunity either to expand card circulation or identify alternatives, such as mobile payment systems.

95. For the 28% of the population with cards, there is one point of sale per 83 card holders, a moderate opportunity to use the cards. Information is not available about the distribution of these point of sale machines, making it difficult to ascertain whether they are evenly disbursed. Statistics on transaction volumes and transaction type are not available, making it impossible to know how issued cards are really being used.

96. All other modes of electronic payments, including internet banking, infokiosks, and mobile payments systems, are reaching a tiny fraction of the population, with less than 0.1% accessibility. This suggests huge potential for expansion through building out wider networks of payment infrastructure and improving the usability and functionality of the existing systems.

97. Demand for e-payment systems is also being generated by the state's requirement to pay salaries for public and state-owned enterprises through debit cards. This program resulted in 670,000 cards issued by June 2011, with more expected because there is more pressure on businesses to use this mode of payment for salaries.[55] As employees receive their salaries directly to their card accounts, there will be pressure to use these funds directly for payments rather than by conversion to cash.

98. The growth of the small business enterprises, which account for 54% of the total GDP, is also driving demand for efficient payment systems.[56] Retail shops, supermarkets, pharmacies, and coffee shops and other small businesses report higher turnover after the installation of point of sale terminals. To provide further incentive to these businesses to use e-payments, the government has provided tax incentives related to the purchase and use of point of sale terminals, making it even more attractive for these users to adopt the technology.[57.]

99. A final driver behind the adoption of e-payment systems, and more specifically use of plastic debit cards, comes from the government itself. Its motivations include a desire to reduce total cash in circulation, increase the rate of turnover of money, and eliminate deficits for the benefit of the economy as a whole.[58] With this support for e-payment systems, it is more or less

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[55] Uzbekistan National News Agency, 2011 *Advantages of the electronic wallet, 2011, http://uza.uz/ru/business/15265/*
[56] UzDaily.com, 2012 *Small Business Product 54% of Uzbekistan's GDP, 2012,* http://uzdaily.com/articles-id-17456.htm
[57] Uzbekistan National News Agency, 2011 *Advantages of the 'electronic wallet',* http://uza.uz/ru/business/15265/
[58] Uzbekistan National News Agency, 2011 *Advantages of the 'electronic wallet',* http://uza.uz/ru/business/15265/

assured that government will support initiatives to grow the e-payment market provided that they fit within the regulatory environment.

4. Constraints

100. Several key constraints affect the development of the electronic payments sector in Uzbekistan, ranging from infrastructure to cultural issues; they will need to be addressed to realize the full potential of e-payments.

101. In infrastructure, limited access to the internet is affecting the uptake of web-based payments systems, including internet-banking platforms from the banks as well as direct payment systems such as Massapay, which is available from the Central Republic Processing Centre. Through increased access to the internet, access to these payments can be expanded, including internet access through mobile phones; this would reduce barriers somewhat as mobile phone usage is already quite high.

102. Expansion of online payment systems is also limited by the back office systems of merchants and service providers who could receive funds electronically. Weak billing systems within various agencies and companies offering utilities and services limits the potential for online payment integration. This needs to be addressed if more suppliers of services are to accept electronic payments.

103. There are several other characteristics of the Uzbekistan economy, including bill denomination, which has influenced the uptake of other channels, such as ATMs. The cost associated with maintaining an ATM is prohibitive since they frequently run out of cash and have size limitations to store any significant float. Another characteristic which influences use of electronic payments is the quite limited accessibility of cash in the economy; it has in some cases resulted in variations of pricing for cash and non-cash payments.

5. Government Support

104. In 2002, Information-Communication Technologies (ICT) development gained new impetus through the government decree—*On further development of computerization and introduction of information-communication technologies*—which approved a new ICT strategy up to 2010. This also led to the establishment of the ICT Coordination Council, which, although headed by a deputy prime-minister, consists of heads of other line ministries including education, economy, finance, trade, and other stakeholders as well as representatives from industry, donors, and NGOs. As the coordinating administrative body it is responsible for the development and implementation of the computerization and ICT. In 2003 an outline for the development of e-commerce was drafted which included the:

(i) improvement of a legislative base;

(ii) development of e-commerce infrastructure;

(iii) development of goods and services databases;

(iv) governmental support and incentives for e-commerce; and

(v) implementation of pilot projects on e-commerce.

105. These were subsequently filled with quantitative and qualitative measures including laws and supporting regulations dealing with e-commerce and electronic payment systems. The current legislative base governing this area includes:

(i) law on e-commerce, 2004;

(ii) law on e-payments, 2006;

(iii) law on electronic digital signatures;

(iv) law on electronic document;

(v) law on protection of information in automated banking systems;

(vi) regulation on the non-cash transactions in the Republic of Uzbekistan;

(vii) regulation on the procedure for electronic payments through the interbank payment system of the Central Bank;

(viii) regulation on the order of service in remote bank accounts;

(ix) regulation on the order of receiving payment agent network payments from individuals' ;

(x) regulation on protection of information in automated banking systems of commercial banks in the Republic of Uzbekistan;

(xi) regulation on the Procedure for registration of bank cards by commercial banks and their circulation in the Republic of Uzbekistan;

(xii) regulation on the Procedure for the use of corporate credit cards in the national currency by legal persons;

(xiii) regulation on the order of sole proprietors of bank cards in the national currency; and

(xiv) rules of the organization of payment systems that use public telecommunications networks.

106. Under Presidential Resolution No. PP 1438 of November 2010—*On Priority Areas for Further Reforms and Sustainability Improvement of Country's Finance and Banking System in 2011–2015 and Achieving High International Ratings*—a working group on e-commerce was set up in the central bank.

107. The central bank approved the concept on implementing ICT in the Uzbek Banking system in August 2011. This includes the automation of various services and the possibility of providing interactive services.

6. Conclusions

108. *Th*e electronic payments market in Uzbekistan is slowly evolving amid ongoing government support and initiatives. Currently, channels based on the use of debit cards are the most popular, although their uptake and usability has room for improvement. Other channels based on the use of the internet and/or mobile phones are present, but require development and support to reach their potential. Of these, mobile-based payment systems are a strong contender to overtake the card-based payment systems, given the relatively high availability of mobile phones. To reach this potential, investment is required to educate consumers, merchants, and mobile payment providers on how to scale up the existing service.

7. Road Map for the Development of Electronic Payment Systems

109. To develop electronic payment systems in Uzbekistan three phases of support are required. Through technical assistance and a pilot project, the expected impact of this intervention would be increased access to financial services. The expected outcome would allow access to effective and inclusive non-cash payment systems. The expected outputs would be to strengthen (i) regulation, (ii) the payments infrastructure, and (iii) capacity to operate and use the e-payment systems.

110. The technical assistance would assess the weaknesses and opportunities to develop e-commerce by improving financial intermediation through the development and implementation of effective and inclusive non-cash payment systems.

111. The first phase of technical assistance will focus on the development of government efforts to support e-commerce with regulation. Since identifying e-commerce as a key area for development in 2003, the government has introduced several measures to help promote payments through electronic channels.[59] To help expand and fully realize the potential of e-payments, additional efforts are required in the following areas:

(i) E-payments supervision: supervision of the e-payments environment needs to be reviewed and potentially further developed to ensure adequate measures are in place to monitor payments through electronic channels.

(ii) E-signatures: electronic signatures are already recognized by the regulations, but there is a need to ensure that the introduction of new forms of electronic payments incorporates the use of e-signatures to ensure a common security platform across all payment channels.

(iii) Branchless Banking: Agent and/or branchless banking are not permitted within the existing regulations, which limits both usability and access to non-cash payment systems. To help expand the services available through e-payment networks to include basic financial services, such as savings deposits and loan repayments, it is necessary to consider how either bank agents or payment service providers could provide services on behalf of financial entities. Additionally, there is need for more entities to provide 'cash out' services if users are to have a convenient means of converting electronic balances to cash. Consideration of the regulations governing agent or branchless banking would resolve this issue, and could be introduced with the necessary safeguards to protect both consumers and the financial system as a whole.

112. The second phase of the work will focus on the infrastructure elements of the e-payments networks, which include availability of mobile payment systems, internet access, payment terminal networks, and unified plastic card accounts.

(i) Mobile payment systems: the penetration of mobile phones is approaching 90%, with 24.3 million users reported as of June 2011. The high availability of mobiles makes this an ideal channel for consumers for making e-payments, or m-payments, if there are strong m-payment providers operating in the market. The

[59] In 2005, a law on e-payments was introduced along with regulations for the use of digital signatures and electronic documents. In 2007, the cabinet of ministers approved the resolution—*About measures on further development of payments conducted under e-commerce actualization*. Finally, in 2008 the resolution, About organization rules of payment systems, which use public telecommunications networks, was also approved. The e-commerce outline is confirmed in Presidential Resolution PP 1438, Annex 2 where under V. "the further development of payment systems and Infrastructure" is stipulated.

development of these service providers is still at a very early stage and those present (such as SMS Tolov) require support to ensure that their services are fully developed and widely available.

(ii) Internet access: online banking and e-wallets are another commonly used e-payment channel that could be relevant if internet access is broadly available across the country.[60] Building strategies to help incentivize internet service providers and/or mobile providers to extend their services to include internet to rural populations will open up this channel to providers of e-commerce.

(iii) Payment terminal networks: plastic card payments require point of sale or other payment terminals that accept plastic cards. The current network, while moderate, is focused on utility payments rather than merchant payments.[61] To help increase the usability of the plastic cards in circulation and help grow the card market in general, the point-of-sale network should be expanded to include points of presence at all mid-sized and large merchants, including retail shops and supermarkets. This could be achieved either through support to point-of-sale network providers or government incentives for merchants to use point-of-sale machines for card payments.

(iv) Unified plastic card accounts: the current infrastructure behind plastic cards requires banks to operate a separate, designated account only for card payments. This setup, while easier to supervise, requires consumers to frequently transfer funds to and from other bank accounts, limiting the usability of the accounts. This segregation of card accounts from traditional savings/current accounts also makes the cost of providing cards more expensive for financial institutions since they must maintain multiple accounts and typically only receive card transactions at the end of a processing period, that is, daily. The Common Republican Processing Centre, which provides the UZ Card, is upgrading its systems to facilitate improved integrations and new payments functionality. Support is required to realize the benefits associated with this upgrade and ensure that end users of plastic cards have access to an account that supports both savings and payments.

113. The third phase, which could be programmed alongside the previous two phases, considers the building of skills and capacity across all players involved in the e-payment environment. This would include: (i) supporting campaigns to explain the benefits of non-cash payments to consumers and merchants, (ii) working with e-payment providers to ensure they have the skills to tailor their services for rural clients, (iii) supporting utility companies to be able to receive and process e-payments efficiently, and (iv) working with regulators to ensure they are well versed in the monitoring of the e-payment systems.

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[60] About over 30% of the population has internet access, largely concentrated in Tashkent city (6.4 million of 8.8 million).

[61] There are 86,100 terminals registered and it is estimated that a majority are held by Paynet agents for processing utility payments. *http://www.cbu.uz/ru/payment_sys/pay_sys_iit_dev_questions.htm*

Table 12: Summary of Outputs and Activities for the Electronic Banking Sector

Outputs	Activities
Strengthened regulatory environment with respect to electronic banking	• Review of the supervision function of the e-payments environment. • Amendments/further development of e-payment supervision as deemed necessary based on the review. • Assessment and implementation of e-signatures to all e-payment channels where applicable. • Review of regulations surrounding the use of agents for branchless banking.
Expanded infrastructure to support e-payments	• Provision of support to mobile payments systems providers to help expand their outreach and services. • Build strategies to help incentivize internet service providers and/or mobile providers to extend their services to include internet to rural populations. • Review of the point-of-sale networks to identify potential interventions to expand on existing networks and usage in the country. • Implementation of the agreed interventions to promote usage of point of sale. • Review of the implementation of unified card accounts to see how best to support the uptake of these accounts.
Improved capacity to operate and use e-payment systems	• Support to information campaigns to explain the benefits of non-cash payments to consumers and merchants. • Capacity building of e-payment providers to ensure they have the skills to tailor their services for rural clients. • Support for utility companies to be able to receive and process e-payments efficiently.

Source: Consultant

Insurance Sector Development

1. Market Analysis

114. Uzbekistan remains among the smallest of insurance markets in the world. The market penetration[62] of 0.4% of GDP in 2010 compares poorly to the global average of 6.9% of GDP and emerging markets average of 3.0% of GDP. Insurance spending per capita is also among the lowest—the insurance density rate equaled $4.50[63] per capita in 2010 compared to the global average of $627.00.[64] The slow penetration of general insurance and negligible growth of life insurance can be attributed to regulatory, social, human development, and cultural factors, as well as the state-dominated market structure. Some of the major impediments include (i) weak competition in the insurance market, with premium discounting as a common practice; (ii) insurance agents' poor knowledge about the products they sell; (iii) an unbalanced relationship between the insured and the insurer, which favors industry profitability but undermines the development of the market; (iv) difficulty in regulating solvency of private insurers, and lack of separation between shareholder funds and policyholder funds; (vi) low per capita income; and.

115. The export-led growth of the Uzbek economy in recent years has, however, contributed to drive demand for protection against risks in business, prompting the government to seek to cement a strong legislative footing for the improvement of the insurance sector. Legislative reforms have created the prerequisites for rapid growth, while promoting and raising the insurance culture among the population. As a result, the composition of the insurance market has changed, both in quantitative and qualitative terms, and current trends hold a lot of promise for growth. The deeper the market reforms proceed, the greater shall be the demand for insurance services.[65]

Table 13: Uzbekistan Insurance Market Compared to CIS Insurance Market

	Gross written premium $ million SUM billion		Overall paid claims $ million SUM billion	Market share of CIS (excluding the Russian Federation) %		Insurance density euro per capita %
	2010	2009	2010	2009	2010	2010
Uzbekistan	$104.5 SUM171.5	$96.4 SUM146,1	$16.5 SUM27.1	2.2	2.2	2.9
CIS	$4,784.3 SUM7847.5	$4,380.4 SUM6641.9	$1,136.4 SUM1864	100	100	27.3

CIS = Commonwealth of Independent States.
Source: Boldijar, Vlad. 2010. *The future is in the East, CIS Insurance Market.* Xprimm.

116. Insurance services play an important role in ensuring the stability of economic processes in the country and social welfare, as well as in stimulating the economy. The insurance market is also a source of institutional investment, underlining its importance. The

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62 Insurance penetration, calculated as the ratio of the percentage of total insurance premiums to gross domestic product, indicates the growth of insurance consumption. Insurance density, calculated as the ratio of total insurance premiums total population, indicates how much each inhabitant of a country spends each year for insurance services.
63 ADB staff estimate.
64 World Insurance in 2010. Sigma No 2/2011, Swiss Re.
65 Hasanov, Humayon. 30.04.2010. *Uzbekistan Today Insured Hence Assured*.

government is therefore taking steps to create favorable conditions for insurance market development.[66]

117. In recent years, foreign investments in the industrial and communication sectors—in addition to the traditional gas and mining sectors—have seen trade, industry and agriculture develop, as well as the growth of rural incomes. The number of business entities in Uzbekistan has grown alongside profitability. These factors have helped create favorable conditions and demand for the growth of insurance services, as evidenced by the growth of the volume of insurance premiums.

118. Based on 2011 results, the share of premiums emanating from insurance contracts with legal entities constituted 73.7% (SUM169 billion or $94.1 million) of insurers' aggregate earnings, up 2.2% over 2010. The share of insurance premiums under contractual agreements with individuals constituted 26.3% (SUM60.0 billion or $33.4 million). The volume growth of total premiums received made up 36.6%. One can therefore infer that particular attention is being given to the important role of this segment of the financial market in the country's economy, with a view to enhancing public confidence in insurance services; Uzbekistan's insurance market is clearly demonstrating high and sustained growth.

d. Market Participants

119. At the end of 2011, Uzbekistan had 37 insurance companies, of which 34 were in the general insurance business, 2 in life insurance; and 1 reinsurance company. The market is dominated by state-owned insurers—Uzbekinvest, Uzagrosugurta and Kafolat. Uzbekinvest is the largest insurer in terms of investments (45.0% of the total held by the subsector) followed by Uzagrosugurta (7.0% of the total held by the subsector). Four new insurance companies entered the market in 2011: Hamkor Sugurta, Halq Sugurta, DD-General Insurance, and GROSS Insurance. The founders of the first two companies are commercial banks and of the latter a pharmaceutical company. Together, the insurers concluded over 5.7 million insurance contracts in 2011, compared to 5.2 million in 2010. There were also three licensed brokerage companies on the market at the end of 2011, 15 adjusters and surveyors, two actuaries (licensed by the Ministry of Finance), and 2 assistance companies (or third party administrators).

120. The adjuster firms provide 24-hour assistance and evacuation service, and are responsible for investigation, verification, and processing of all documents submitted at the time of a claim. They are paid a previously agreed, fixed fee. Their assessments are also independently verified by a valuation department under the Ministry of Finance. It takes about one month for the claimant to obtain compensation from the insurance company.

121. The assistance companies focus on the medical assistance business (cashless hospitalization) and have tie-ups with insurance companies offering health insurance and with medical institutions. They also run a helpline and call center to help health insurance customers. However, there are no mandated training or licensing requirements; a system of accreditation of assistance companies would therefore be important to improving the credibility and quality of service.

122. The increasing number of insurance companies—despite the increase in the minimum authorized capital requirements—emphasizes the high investment interest for the insurance industry and its attractiveness. The increase in the number of insurance companies also contributes to the growth of market capitalization and expands the capacity of the market as a

[66] Uzbekistan Business News. 08.04.2010. *The size of Uzbekistan's insurance market increased by 62.2% in 2009.*

whole. This is important given the rapid yearly growth of the volume of insurance transactions, both through expansion of the insurance sector and due to the natural growth of the market as well as strong economic growth.

123. Insurance agents actively participate in the sale of insurance services and the promotion of new insurance products and are an important factor for promoting the growth of insurance. According to the legislation on insurance activity in Uzbekistan, both individuals and legal entities can be insurance agents. There is no licensing requirement stipulated for insurance agents. As noted, the skills of insurance agents are far from satisfactory, with many working with inadequate knowledge of the product they are selling.

124. As of the end of June 2011, 6,610 insurance agents operated in the insurance market: 5,197 (78.6%) are individuals and 1,413 (21.4%) legal entities. Of the total, 44.7% operate in rural areas. According to SAIPRO, insurance agents procure the largest portion of insurance premiums through mass-marketed insurance products such as insurance against accidents, vehicle insurance, compulsory insurance of vehicle owners' civil liability, and others. They are paid by commissions stipulated by agreement with an insurance company, with the maximum set at 25%. The commission is paid from insurance premiums provided by the insurance agent. Commissions paid to insurance agents cannot exceed 25% of the aggregate sum of insurance premiums. In 2010, insurance companies' total expenses for commissions to insurance agents comprised 10.8% of total earnings.

125. The cost of distributing insurance products remains high and therefore makes it unpopular and unaffordable among the wider population segments. To expand the outreach of insurance among households and make insurance offerings more attractive, conscious effort is needed to bring down distribution and administration costs. In the opinion of the Chamber of Commerce and Industry, integration of electronic payment systems should not be limited to banking-related transactions, but should also look into a broad range of financial services, including insurance.

e. Industry Association

126. The Association of Professional Participants of Uzbekistan Insurance Market is the independent association of insurance industry participants. However, membership of the association is not mandatory, resulting in a lack of active participation from stakeholders.

127. The association recently put together working groups to examine issues pertaining to the development of the insurance industry, including: (i) investment activity and solvency, (ii) accounting and auditing issues in insurance, (iii) property and transport risk insurance, (iv) credit finance and trade risk insurance, (v) life insurance, (vi) reinsurance, and, (vii) compulsory insurance types. They are also looking at employer’s liability insurance, stabilization reserves, rural insurance agencies, and business ethics and corporate governance.

128. The association aims to develop into a self-regulating organization to aid and assist the State Insurance Supervision Board in carrying out its market conduct supervision. This would involve training and licensing of insurance agents, brokers, adjusters, and others, and assuming responsibility for enforcing their code of conduct. The association is also exploring the possibility of setting up an insurance training arm and forging collaboration with established and reputable international training bodies in insurance and risk management overseas.

f. Premium Underwritten and Claims Paid

129. According to SAIPRO, insurance companies in 2011 underwrote premiums worth over SUM231,6 billion ($129 million equivalent), up 36.6% from 2010. The share of insurance premiums received from contracts with legal entities accounted for 73.7%, while the share of insurance premiums from contracts with individuals made up 26.3%.

130. In the first half of 2011, gross written premiums increased 42.1% over the same period in 2010, to a total of SUM121.5 billion ($70.9 million equivalent); insurance companies concluded over 2.9 million insurance contracts in the period.

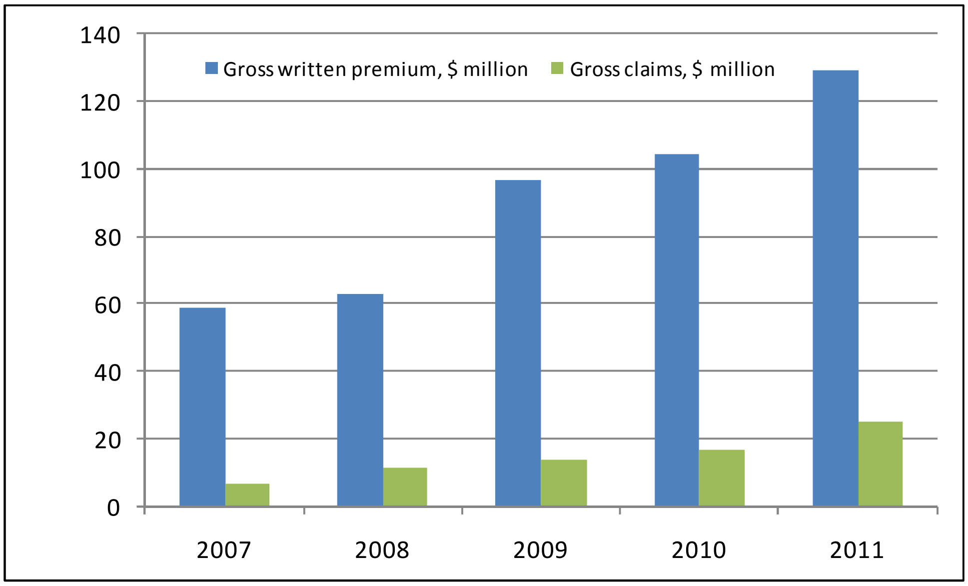
131. The President of Uzbekistan declared 2011 the year of Small Business and Private Entrepreneurship Year, with a focus on insurance for small business and private enterprises. Over 65% of all contracts during the year were underwritten in rural areas, which resulted mainly from mass-marketed insurance. The Tashkent region accounted for 50% of premiums, while Fergana, Andijan, Kashkadarya and Samarkand regions contributed about the same percentage. In the fourth quarter of 2011, a new Insurance company, Halq Sugurta, was licensed, and it promotes microinsurance type of products.

Table 14: Insurance Premium and Claims Trends, $ million, SUM billion

	2007	**2008**	**2009**	**2010**	**2011**
Gross written premium	$58.9 (SUM75.9)	$63.2 (SUM88.2)	$96.4 (SUM146.1)	$104.5 (SUM171.5)	$129 (SUM231.6)
Gross claims	$6.9 (SUM8.9)	$11.2 (SUM15.6)	$13.7 (SUM20.8)	$16.5 (SUM27.1)	$25.1 (SUM45.1)

Source: SAIPRO and *"Insurance market in 2011",* Bizness Vestnik Vostoka newspaper 2012, www.uzreport.com

Figure 7: Gross Written Premium



Source: SAIPRO

132. The value of claims paid by Uzbek insurers rose to SUM45.1 billion ($25.1 million) in 2011, up 67% over 2010. The claims ratio was over 19% of the total value of underwritings. In total, Uzbek insurers paid out SUM27 billion ($16.5 million) of insurance claims. This growth was mainly due to an increase in payouts in both voluntary insurance and compulsory insurance. This is in stark contrast to growth rates of compulsory insurance payouts that had so far exceeded the growth rates of voluntary insurance payouts for the previous four years.

133. The major lines of insurance business are compulsory motor, compulsory employer's liability, contractors all risk insurance, export credit insurance, property insurance (including coverage against all types of catastrophes). Although there are more than 800 insurance products on offer, they do not reflect unique product offerings that can clearly differentiate one from the other. Moreover, there is a lack of information and data about how products have actually performed.

g. Mandatory Insurance

134. There are six types of mandatory insurance; the introduction of mandatory motor third party liability insurance in late 2008 pushed up the Uzbek insurance market since 2009.

135. A policyholder's protection fund guarantees payments to all uninsured low-income and handicapped workers, up to 50% of the original sum insured, which is about SUM5.4 million ($3,000) per driver. Of the total premium, 65% is for coverage for life and health or accident and 35% for property damage. The maximum limit of compensation for property damage is about SUM1.9 million ($1,500).

136. In 2011, 28.3% of total gross premiums were collected on mandatory insurance segments, which amounted to SUM65.6 billion ($36.5 million), with a 45.4% growth rate. In 2011, 5.7 million insurance contracts were signed, out of which about 75% are voluntary insurance contracts.

137. According to local industry experts, the motor third party liability insurance segment had almost reached its potential by the end of 2011, leaving little room for a substantial increase in insurance premium in this segment, with the possible exception of automobile own damage insurance. Going forward, the positive dynamics of mandatory insurance need to be supported by market segments such as employer's liability, health, and environment insurance, or by the mandatory construction and erection all risk insurance.

Table 15: Market Portfolio of Uzbekistan Insurance Market

Business line	Gross written premium $ million (SUM billion)		Paid claims $ million (SUM billion)		% of gross written premium	
	2011	2010	2011	2010	2011	2010
Total market	135.14 (231.60)	109.64 (175.00)	26.31 (45.10)	17.29 (27.60)	100	100
Mandatory	38.24 (65.54)	29.27 (46.72)	…	…	28.3	26.7
Voluntary	96.88 (166.05)	80.36 (128.27)	…	…	71.7	73.3

… = data not available.
Source: PRIMM Insurance.

138. On risks undertaken by insurance companies, the voluntary insurance segment grew noticeably quickly: in the first six months of 2011, gross written premiums on this insurance line increased in local currency by 50.8% to SUM84.9 billion ($49.2 million).

139. Large businesses and banks are the main promoters of insurance products, not the insurance companies themselves. For the compulsory insurance business, the competition for commission earnings often drives sales. Many insurance companies are not generating profits, despite the low claims ratio.

h. Declining market share of state insurers

140. The steady decline of the share of state insurance companies in total underwriting, currently around 37%, is another noticeable trend over the past seven years.

Table 16: Market Share of Top 10 Insurers in Uzbekistan (%)

	2011	2010	2009
State owned insurers (3)	37.12	36.90	36.97
Top 10 insurers including state-owned insurers	75.15	76.90	70.00

Sources: PRIMM Insurance, SAIPRO.

i. Life Insurance

141. Group endowment and group term life policies, issued for 30-month periods and renewed on an annual basis, are the main types of products sold. A guaranteed fixed bonus of 1% is paid to policyholders, while insurance commission payable is 3.5% of the premium per policy

year. In 2007, the government allowed a 100% tax deductible on the life insurance premium. In the past, there was a practice of compulsory mortgage insurance with Zameen Bank (which was later merged with Ipoteka Bank). This has since been discontinued and mortgage insurance is now purchased on a voluntary basis.

142. Annuity products are also being sold, which is compulsory under employer's liability insurance where employers contribute premium and in the event of the death of an employee, purchase annuities in the name of the beneficiary.

143. The State Insurance Supervision Board stipulates investment restrictions on bank deposits (70%), shares (10%), and bonds (20%).

144. The World Bank in 2011 conducted a pilot study with a limited focus on life insurance; important recommendations include the development and integration of the financial markets, including those for both fixed-income instruments and shares. This aims to encourage the participation of insurers as institutional investors in the financial markets. The study also suggests the adoption of taxation policies that encourage the purchase of insurance and calls for designing social insurance programs in a manner that facilitates the use of supplemental private insurance and encourages the development of private pension funds.

145. To increase consumer willingness to use insurance, the World Bank study suggests the use of financial literacy programs to educate consumers on the risks they face and the tools, including insurance, to manage them. It also calls for establishing insurance mechanisms, such as micro-insurance and Islamic insurance, which could enable a wide range of consumers to make use of insurance. Steps that might help the insurance industry meet the needs of consumers include the development of capacity building programs to educate and train accountants, auditors and actuaries, and other technical specialists; adopting strong professional standards that are consistent with those used internationally; encouraging the formation or strengthening of professional bodies for accountants, auditors and actuaries; establishing robust and flexible payment systems; and encouraging the formation or strengthening of insurance industry associations along with adoption of codes of ethics. To strengthen regulation and supervision an assessment of the existing regulatory framework and supervisory practices against the Insurance Core Principles is an important item going forward. This can be supplemented by developing and implementing plans to deal with shortcomings pointed out in the assessment report, in a manner appropriate to the level of development of the market, together with education and training of insurance supervisors. Lack of awareness is among the main challenges for the growth of life insurance. Other areas include improving professional training of insurance personnel—in the design of products, technical analysis, and portfolio investments. The development of a mortality table is also an urgent need.

j. Health Care

146. The International Monetary Fund's Poverty Reduction Strategy Paper (2008) highlights the importance of introducing a financing system through health insurance as an important mechanism for achieving healthcare reforms. According to the World Bank,[67] in Uzbekistan, the proportion of total health expenditures derived from private sources is lower, at about 50%, than in several other countries in the region that are classified as lower middle income (such as Armenia, Azerbaijan, and Georgia), where the proportion is about 70%. These differences may reflect the varying degrees of reduction in public health expenditures after the collapse of the Soviet Union.

k. Reinsurance

147. All property in Uzbekistan needs to be underwritten by a domestic insurer before being reinsured. There is an obligatory cession[68] limit which is currently set at a minimum of 5% of the premium. Reinsurance is on an auto-fac[69] basis and there are no reinsurance treaties. A distortion in the tax regime also rewards reinsurers by way of tax relief if they reinsure outside the country. In addition, foreign exchange convertibility is a major issue for inward cessions by the reinsurers. The government retains 50% of the inward cessions premium received in foreign exchange after conversion into local currency. At the time of a claim, convertibility becomes a problem for reinsurers and/or insurers as they are unable to meet their obligations in a timely manner after having accepted risk from outside the country.[70] They are also exposed to foreign exchange risk.

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67 The World Bank. 2006. Gottret, P., George Scheiber. *Health Financing Revisited, A Practitioners Guide*.

68 Obligatory cession is the minimal portion of the insurance business to be compulsorily reinsured with another insurer/reinsurer.

69 Auto fac is a form of reinsurance whereby the ceding company cedes and the reinsurer must assume a certain level of risk on all policies of a certain type that meet specific criteria based on the provisions of the reinsurance agreement.

70 Institute of Credit Management (ICM) Regulation No 245 dated 29 July 2000.

148. The volume of ceded premiums has increased significantly with the growth of the insurance market in 2010. In 2011, insurance companies ceded insurance premiums worth SUM59.7 billion ($33.2 million) by way of reinsurance. This is the highest increase in the last five years, and exceeds the 2010 level by 44.9%. The growth in volume of ceded premium was caused by growth of the volumes of insurance obligations taken by insurers during 2011. In 2011, insurers accepted obligations worth over SUM97.2 trillion ($54.1 billion) in aggregate, adding 24.4% as against the previous year.

149. In 2011, 74.5% of reinsurance premiums were ceded to foreign insurers and reinsurers, with 25.5% retained by local insurers and reinsurers. The retention exceeds the 2010 figures by 8.2 percentage points. In 2010, the volume of ceded premiums amounted to 24% of total underwritings. Thirty companies ceded risks in reinsurance, of which 18 ceded abroad to 30 foreign countries (40.4% to the United Kingdom, 22.5% to the Russian Federation, 14.2% to Germany, 4.5% to Ukraine, 2.7% to France, 2.4% to the United States, 2.4% to Malaysia, and 2% to Switzerland). The aggregate share of other states in reinsurance premiums in outward insurance comprised 8.9%.

150. Based on the results of 2010, the share of property insurance in outward reinsurance was reduced by 4.2 percentage points and made up 77.1% of the outward reinsurance. The growth in the share of personal insurance in reinsurance is also connected with the growth of earnings in such types of insurance, for example, insurance of individuals going abroad and voluntary medical insurance. The shares of liability insurance and compulsory insurance in outward reinsurance have also demonstrated a stable tendency over the last three years. In fact, the share of liability insurance in outward reinsurance declined from 16.6% in 2008 to 13.8% in 2010. With the introduction of Compulsory Insurance for Employers' Civil Liability (CIECL), mandating insurance against construction and assemblage risks, the share of compulsory insurance in outward reinsurance increased by 3.7% over the period 2007-2009 and comprised 4.1% of the 2010 results.

I. Insurers' Assets

151. Changes in the volume of insurance reserves, both qualitatively and quantitatively, influence insurers' investment opportunities. The total volume of insurance reserves that insurers accumulated for meeting obligations on insurance contracts underwritten comprised SUM136.2 billion ($83.1 million) in 2010, a 53.6% increase compared to the volume of reserves held in 2009. SAIPRO noted that the rapid growth of insurance reserves in 2010 was stimulated by an increase in the overall volume of insurance premiums, and included increases in insurance reserves for enhanced compulsory insurance premiums, e.g. civil liability of car owners and compulsory insurance of the civil liability of employers.

152. In addition to market-related factors, the government, by providing tax preferences and benefits, also helps enhance the quality of investment. In 2010, insurers' assets were SUM412.5 billion ($251.6 million), a 9.3% increase over the previous year.

153. This is indicative of the fact that insurers are strengthening the stability of operations by progressively increasing the share of insurance reserves to total assets, thereby creating conditions for the further expansion of activities.

m. Insurers' Investments

154. As competition in the insurance market increases, so should investment income in the insurance company's profit. International practice reveals that more than 70% of insurance company income is comprised of revenue from investments. In Uzbekistan, so far, investments have provided a significant proportion of income for many insurers. As of 1 January 2011, insurers' invested funds amounted to SUM367.4 billion ($204.4 million), up 23% over 2010. Over the past 5 years, insurers' invested funds increased more than 1.6 times, with average annual investment growth of 11.1%–15.7%.

155. As already discussed, the share of compulsory insurance in the insurance market stabilized in 2011 and volume growth of insurance premiums returned to its natural level (about 20%). Since insurance reserves[71] are the main source of investment funds, this stabilization also had an effect on investment volume growth rates. According to SAIPRO, although insurers' investment portfolio did not change significantly in 2011, the structure of investments improved.

156. As has been the case in past years, the largest investment shares were in deposits and securities. In 2011, deposit share grew 0.9%, while the share of securities decreased 3.2%. Deposits amounted to 45.1% of insurers' aggregate investments and securities 41.2%. The volume of deposits in 2011 increased 25.4% to SUM165.7 billion ($92.3 million); securities increased only 23.7% to SUM151.5 billion ($84.4 million).

157. For 2011 the share of deposits is expected to increase as a result of the adoption of the new decree, *On introduction of changes and amendments to the Regulations on insurers' and reinsurers' solvency*.[72] Until 2010, insurance companies directed their investments to the charter funds of commercial banks. According to the amendments, the aggregate sum of insurers' (reinsurers') investments into charter funds of other legal entities will be limited to 50% of the sum of the sources of insurers' (reinsurers') own funds. This applies with the exception of participation in charter funds of commercial banks with positive reports of an international auditor on the results of previous fiscal year.

158. Shares are the predominant instrument in the structure of securities (92%). Uzbekinvest National Company for Export and Import Insurance has the largest volume of investments floated in shares, and it leads in aggregate market investments (45.4%). The investments of the other top 10 insurers in this instrument are: Uzagrosugurta (7.1%), Kafolat (4.7%), Alfa Invest (4.5%), Transinsurance (4.1%), Alskom (2.8%), Temir-yo'l sug'urta (2.5%), Ingo Uzbekistan (2.4%), Asia Insurance (2.2%), Transinsurance plus (1.9%).

159. On the whole in 2011, the quality of insurers' investment portfolios tended to improve and posted record growth rates over the 5-year period up to 2011. But insurance company investment by volume in aggregate investments signals a downward trend; the share of the top ten insurance companies in aggregate investments was 89.9% in 2008, 82.8% in 2009, 79.4% in 2010, and 77.6% in 2011.

160. Insurers also decreased their investment in real estate by 0.7% in 2011, putting their share at 6.5%. The share of loans, participation in charter funds of enterprises, and other investments also decreased in the aggregate insurance portfolio; as a result, loans in aggregate

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[71] Reserves in compulsory classes account for 40% of portfolio; stabilization reserves for 10%.

[72] Order of the Minister of Finance of the Republic of Uzbekistan, *On introduction of changes and amendments to the Regulations on insurers' and reinsurers' solvency*, registered by the Ministry of Justice under No.1806-1 dated 27 December 2010

investments were 0.97% in 2011; participation in charter funds comprised 5.6%; and other investments amounted to a 0.6%.

2. Regulatory and Policy Issues

161. Uzbekistan adopted the insurance law, enabling the licensing of insurers, in 2001, while regulations governing the insurance market came into effect in 2008. A separate chart of accounts has been designed and is being implemented by local companies. Although the branches of international insurers also prepare accounts in accordance with International Financial Reporting Standards (IFRS) 4 for global reporting, the State Insurance Supervision Board does not have a road map for implementation of IFRS 4 A. While this area remains a priority, any change is likely to be gradual.

162. Insurers are required to report on a quarterly basis to the State Insurance Supervision Board: premium, technical reserves, solvency, insurance investments, reinsurance, and so on. Insurers submit returns manually. Monitoring the solvency of insurance companies is also difficult, and there is no separation between shareholder and policyholder funds.

163. Off-site inspection is mostly confined to the checking of documents for legal compliance only. Neither follow-up questions nor feedback is sought from the insurance entities that have furnished returns. The State Insurance Supervision Board cannot decide on conducting an on-site inspection itself. Instead, this decision is made by a special cell within the Ministry of Finance in consultation with the general prosecutor's office, the rationale being, as much as possible, to keep the burden of inspection off the insurance operators and to avoid any duplication. About 10–12 inspections of insurance companies are carried out every year.

164. Shortfalls in solvency can lead to fines and suspension of up to 10 days. The Ministry of Finance levies the fines.

165. In accordance with legislative changes amending requirements for insurers' minimum of share capital, within two years—1 July 2012 to 1 July 2014—insurance companies in Uzbekistan shall increase their share capital as follows:

- For general insurance activity: to SUM2.64 billion ($1.46 million).
- For life insurance activity: to SUM3.51 billion ($1.95 million).
- For mandatory insurance activity: to SUM5.27 billion ($2.93 million).
- For exclusive reinsurance activity: SUM11.71 billion ($6.50 million).

166. According to the new regulations, the next step in increasing share capital starts from 1 July 2014, as follows:

- For general insurance activity: to SUM3.51 billion ($1.95 million).
- For life insurance activity: to SUM4.68 billion ($2.60 million).
- For mandatory insurance activity: SUM7.03 billion ($3.90 million).
- For exclusive reinsurance activity: to SUM14.05 billion ($7.80 million).

167. The development of insurance culture has been hampered by the lack private insurance in the Soviet era, while the difficult early years of a largely unregulated insurance market after that era destroyed consumer trust, which must now somehow be regained.

168. The following government midterm measures are aimed at creating a favorable environment for the development of insurance:[73]

(i) advancing the competitive environment in the insurance market, the development of modern types of insurance activities and increasing capitalization in insurance companies;

(ii) improving the regulatory and legal framework of insurance activities and insurance supervision in accordance with international practices;

(iii) integrating Uzbekistan's insurance market with international insurance markets by a set of measures for its accession into the International Association of Insurance Supervisors;

(iv) facilitating higher volumes, scope, and quality of insurance services in business insurance, export-import transactions, long-term life insurance, including individual insurance accounts and designing insurance products to safeguard real estate and life insurance;

(v) developing and introducing of a computer-based data collection and processing system in the State Inspection for Insurance Supervision under the Ministry of Finance;

(vi) creating conditions for improving the system of training, retraining, and professional development of insurance market participants;

(vii) improving the forms and methods of stimulating and supporting domestic exporters in foreign markets, including through expanding the range of banking services related to export crediting, insurance of export credits and/or granting of counter bank guarantees through a public insurance system to increase private sector involvement in export activities; and

(viii) improving the pension system in the medium- and long-run alongside the strengthening of market mechanisms and a gradual transition from the principles of distribution to insurance and savings.[74]

3. Access to insurance

169. In 2008, a TA financed by the United Nations Development Programme (UNDP) reviewed the insurance industry legal and regulatory frameworks, proposed actions to help extend insurance to low-income households and highlighted the potential for agriculture insurance and crop insurance.

170. As noted earlier, authorities licensed a dedicated micro-insurance company, Halq Sugurta (People's insurance) promoted by Halq Bank, with technical assistance from German Foundation of Savings Bank. CARD Micro-insurance in Philippines trained Halq Sugurta staff, and the company has launched two microinsurance products featuring credit life (covering

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[73] IMF Country Report No 08/34, January 2008. *Republic of Uzbekistan: Poverty Reduction Strategy Paper.*

[74] ADB's Private Sector Assessment of Uzbekistan also highlights that securities market development would necessitate the growth of institutional investors, such as nonbank financial institutions. A number of investment funds, established in the mid-1990s as vehicles for the privatization of SMEs, already exist. However, the shortage of attractive investment opportunities has stunted the growth of investment funds. An important initiative for promoting institutional investors would be to support the development of market-based insurance and pension business.

borrower's liability of unpaid loan in the event of death) and accident and property insurance for SMEs.

171. Microinsurance, still in its nascent stages, needs to be further explored. And creating awareness is key; players need more information for designing, distributing, and servicing insurance products on a competitive, yet sustainable basis.

4. Areas of focus for insurance market development

172. The State Insurance Supervision Board views the strengthening of supervisory capacity for insurance markets as a key area of focus. In doing so it would like to ensure that the legal and regulatory frameworks in compliance with the International Association of Insurance Supervisors (IAIS) Insurance Core Principles. The solvency regime should be developed in line with Solvency I and Solvency II directives. This also points to insurance loss reserving based on international practice, and regulation of reinsurance and investments based on international best practice.

173. By ensuring the electronic submission of returns and documents and analysis the State Insurance Supervision Board can make both off-site and on-site supervision more efficient and effective, looking more credible in the process.

5. Roadmap

174. Insurance and contractual savings institutions need to be strengthened and developed; through expanded activities, these institutions can become a vital vehicle in the accumulation of savings and stimulation of investment that can underpin economic growth. The banks are at present the major institutional investors. Nonbank financial institutions have remained largely underdeveloped. Currently, the variety and quality of nonbank services are limited and total insurance sector assets are equivalent to about 1% of GDP. There is, however, potential for insurance companies to become major institutional investors alongside banks, provided an adequate regulatory and legal framework is put in place.

175. Financial sector regulators and policy makers can play an important role in addressing challenges faced by both the insurers and the insured. They can promote policies that enable the market to develop while helping to build and retain consumer confidence and trust. This can be achieved through regulation and supervision that promotes a safe, sound, competitive, and accessible insurance sector. Promotion of information sharing with consumers, both firms and individuals, can also help deepen the insurance market.

176. The key development issues that need to be addressed are the legal and regulatory frameworks, and capacity of the SISB and relevant authorities. Increased penetration of insurance services can play an important role in diversifying the financial sector, which is dominated by banks, and enhance the ability of the financial system to manage financial shocks and periods of uncertainty. This will contribute to the stability of economic processes through better risk management, enhance social welfare with greater financial security, and stimulate economic growth by encouraging the flow of long-term private capital for infrastructure investment.

177. The government has asked ADB to provide technical assistance to help develop the insurance market. Such technical assistance could reinforce the active steps that the government and market participants have already taken to create more favorable conditions for the expansion of a functional and efficient insurance subsector in Uzbekistan. This is needed to

help mitigate insurable risks for small and medium-sized enterprises and individuals and increase the accumulation of contractual savings used for investment in the country. The TA could, in particular, contribute to improved efficiency of supervision of the insurance system and deepen insurance penetration through better product design and use of alternative distribution channels. An action plan for the development of the insurance sector over the medium- and long-term would help strengthen the confidence of market participants by enhancing the capacity of the insurance market regulator, i.e., the SISB, facilitating the implementation and observance of international insurance principles and standards, and promoting greater customer protection..

178. The TA would undertake assessments to determine compliance with international insurance standards, including the Insurance Core Principles (ICPs) of International Association of Insurance Supervisors (IAIS), estimate market potential, and identify needs for capacity building. It would support the development of an action plan to increase penetration of insurance services, and an electronic document management system for off-site and on-site monitoring that will also include pilot testing.

179. Such support is consistent with the core area of finance sector development as outlined in ADB Strategy 2020, especially in ensuring sustainable private sector-led economic growth. The country partnership strategy (CPS) 2012–2016 advocates demand-led technical assistance in areas identified jointly with the government, including assistance to strengthen the regulatory framework of the insurance market.

180. It is also consistent with the Presidential Resolution No. 1438 dated 26 November 2010, which calls for further reforms and sustainable improvement of Uzbekistan’s finance and banking system, and initiating measures aimed at development of the microfinance and nonbank financial subsectors through a number of comprehensive activities set out in an action plan for 2011–2015. The TA would specifically support activities detailed in Section III of Annex 2 of the action plan, Insurance Market Development and Expansion of Insurance Companies Operations.

181. The expected impact of the TA would be improved outreach of insurance. The expected outcome would be strengthened policy and regulatory environment for insurance.. The proposed technical assistance is summarized in Table 17.

Table 17: Summary of Recommended Technical Assistance for the Insurance Sector

Outputs	Activities
Gaps in existing policy and regulatory framework identified	• Assess compliance with international standards, including the IAIS ICPs, International Financial Reporting Standards (IFRS) and others, to identify policy and regulatory gaps. Recommendations on changes to the policy and regulatory framework will be developed.
Electronic document management system developed	• Analyze the existing system for submission of returns, off-site and on-site analysis, preparation of reports, and archival of returns and reports. • Develop a web-based information technology tool capable of seamless integration of reporting by insurers and insurance intermediaries and carrying out analysis of core functions of insurers, e.g., solvency, reinsurance, investment etc. • Develop and maintain a reliable data base to track online reporting by insurers and intermediaries as well as various on-site and off-site analysis and internal reports. • Conduct pilot testing of the electronic document management system.
New insurance products and distribution channels identified	• Identify measures to promote access to the insurance market by the low income population. • Suggest indicative design and actuarial pricing for insurance products, including life and annuities, disaster risk financing solutions to manage catastrophe risks, and microinsurance. • Develop alternative distribution channels to expand outreach.
Capacity of SISB staff and insurance market participants improved	Provide training and workshops to • strengthen skills in prudential supervision (off-site and on-site) with specific reference to solvency, investments, reinsurance, and anti-money laundering/combating financing of terrorism (AML/CFT); • facilitate for SISB staff to attend IAIS meetings; • provide training on electronic document management system; and • develop a framework for setting up the training center, Sugurta Olami (World of Insurance), to help meet the professional training and education needs of insurance market participants in collaboration with an internationally accredited professional body of actuaries and the Tashkent Financial Institute.

IAA = International Actuarial Association, IAIS = International Association of Insurance Supervisors, ICPs = Insurance Core Principles, IFRS = International Financial Reporting Standards,

C. Securities Market Development

1. Securities market

182. Uzbekistan's financial markets are in their nascent stages. Although there has been some progress with banking reform, the banking sector is remains relatively inactive in financial intermediation and further restructuring is needed. State-owned commercial banks continue to hold a dominant share of banking sector assets and are still subject to directed lending. This distorts the supply of and demand for credit, as lending is not based on underlying credit fundamentals; with funds not always being invested in economically viable projects. It also appears that the interbank money market, while described as liquid, tends to be active only as a term market; for maturities from 1–9 months, with little interbank activity in the (overnight) call market. In addition, and possibly associated with the reliance on direct monetary policy tools rather than indirect monetary policy instruments, there is no market for repurchase agreements (repos).[75] The absence of an active short-dated interbank market has implications for the liquidity of banks.

183. Concerns related to the securities market include the: (i) relatively stable development of share prices since 2007, which cast doubt on whether prices reflect underlying asset values; (ii) the small government bond market, which exists only as a 'nominal' market, with bonds placed directly by the Central Bank to banks (usually state-owned banks); (iii) the absence of unified financial statistics; (iv) limited publicly available information on government bonds or on the government's debt management strategy; (v) limited exchange rate flexibility and unclear convertibility restrictions. The reliance on directed lending causes a further problem, in that this stifles the development of a sound credit culture where lending is based on underlying fundamentals.

Box 2. Securities Market Development in Thailand

Thailand's securities provides context, given that country's progress in developing its securities market in the aftermath of the Asian financial crisis of 1998/99. Table 18 details broad financial market parameters for Uzbekistan and Thailand, which indicate that Uzbekistan's securities market—equities and government bonds—are small, both as a share of GDP and relative to Thailand.

Table 18: Financial Market Metrics—Thailand and Uzbekistan (end of period)

	2009		2010	
	Thailand[1]	**Uzbekistan[2]**	**Thailand[1]**	**Uzbekistan[2]**
GDP at current prices ($ billion equivalent)	263.69	32.97	318.81	38.95
Equity market capitalization (% GDP)	64.95%	7.30%	82.50%	9.4%.
Government bonds outstanding[1] (% GDP)	52.10%	0.11%	54.40%	0.09%
Corporate bonds outstanding (% GDP)	13.20%	0.07%	12.40%	0.42%
Domestic credit to private sector (% GDP)	68.88%	14.60%	70.42%	….

…. = data not available.
[1] Sources: ADB Key Indicators 2011, Asia Bonds Online, Stock Exchange of Thailand.
[2] Sources: ADB Key Indicators 2011, EBRD Transition Report 2010, UZB Economic Trends 2009 and 2010.

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[75] Repos are liquidity generating instruments, widely traded in the interbank market, that underpin primary dealer activities in a liquid government bond market.

184. There are presently few financing channels available for either the public or the private sectors (Table 19). While the economy is still relatively small, it is growing, especially supported by the availability of natural resources. It is crucial that the financial sector similarly develops to reach a critical mass that can support underlying economic growth. In turn, the government bond market plays a pivotal role in underpinning the development of the fixed income markets.

a. Supply of Securities

i. Government Bonds

185. Government debt fulfills two functions: it provides finance to the government, and it forms the foundation of the financial sector. At the same time, it should be noted that government bonds are unique in their effective risk free status—critical to bank capital usage—and that they are the most liquid fixed income instruments.

186. Risk management products and private sector debt instruments depend on an active market in government bonds for price discovery—a feature that confers benchmark status on government bonds. The government bond market is therefore not an isolated part of the financial system; rather, the government bond market is tightly integrated with other markets including debt, equity, foreign exchange and their respective derivatives. That said, excessive government borrowing through the debt markets will distort price signals. It is therefore important to maintain balance in government credit demands.

187. The government bond market plays a key role in underpinning bond market growth because the early stages of securities market development will be directed to building the government bond curve through the issuance and trading followed by the corporate bond market.[76] As the government bond market grows so, too, does the experience and skill set of industry professionals—necessary conditions for the development of a corporate bond market. In this sense, the secondary government bond market also acts as a precursor to the development of the corporate bond market given the skills required to actively trade in government bonds.

188. Several prerequisites exist for establishing an efficient government securities market. These include factors such as credible and stable government; sound fiscal and monetary policies; effective legal, tax, and regulatory infrastructure; robust settlement arrangements; and a liberalized financial system with competing intermediaries. If such basics are weak, the priority should be to adopt and implement a stable and credible macroeconomic policy framework as well as reform and liberalize the financial sector and ensure a proper pace of liberalization in different areas (for example, financial sector versus capital account and/or exchange rate measures).

189. As a first step to developing the bond market, the government introduced treasury bills in 1996,[77] with 18-month (medium-term) treasury bonds first being issued in 2003. From 2003 to end-September 2006, the government issued 58 medium-term treasury bonds. There has been subsequent mention of the need to lengthen maturities,[78] but issuance remains relatively short-dated. Recently, the tenor of government bond issuance has been exclusively 2 years.

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[76] Both issuance and trading activities are essential to providing a strong profit base that will attract and maintain market intermediaries.

[77] ABD. 2005. *Development of the Capital Market* TA 4146-UZB Final Report.

[78] The government in 2004 decided to issue bonds with maturities up to five years.

190. The Main Administration of State Budget of the Ministry of Finance is responsible for the government's budget management and, presumably, debt management. It is apparent though that the government does not involve financial intermediaries in discussions regarding debt management strategy. Nor are details of the government's financing plans circulated in the public domain in a timely manner.

191. Of equal importance, information on government bonds is not widely disseminated and there appears to be neither accurate nor timely data, making it difficult to carry out in-depth analysis of the government bond market to ascertain information about the maturity spectrum or the level of consolidation of government debt. However, anecdotal evidence points to a government bond market that is short-dated, which creates rollover risk for the government and, at the same time, fails to meet the needs of investors seeking long-dated assets.

192. Government bonds are reportedly issued via auction at weekly trading sessions at the Republic Stock Exchange. Two days prior to the auction, the Ministry of Finance prepares documentation and sends it to the central bank,[79] at which time it notifies prospective bidders of the terms of the forthcoming issue. That said, in 2011 there were no trading sessions held between January and May. Consistent with this, market intermediaries commented that government bond issuance is infrequent.

193. In 2010 total government bond issuance was SUM17.1 billion ($10.4 million), placed by way of sixteen auctions.[80] As of January 2011 there were 33 issues of government bonds outstanding, for a total value of SUM53.01 billion,[81]($29.5 million) or 0.12% of GDP. From table 19 it can be observed that the ratio of government bonds outstanding relative to GDP has progressively declined from 2006; that is, growth in the government bond market has not kept pace with GDP growth.

Table 19: Financial Market Metrics in Uzbekistan (at period end)

	2007	**2008**	**2009**	**2010**
GDP at current prices ($ billion equivalent)	22.31	27.90	32.97	38.95
Equity market capitalization (% GDP)	8.80%	10.40%	7.30%	9.4%
Government bonds outstanding (% GDP)	0.18%	0.16%	0.11%	0.09%
Corporate bonds outstanding (% GDP)	0.07%	0.07%	0.07%	0.42%
Domestic credit to private sector (% GDP)	15.00%	15.00%	14.60%	….

GDP = gross domestic product, … = data not available.
Source: EBRD Transition Report 2010, Uzbekistan Economic Trends 2009 & 2010, *Capital Markets in Central Asia* Jurgen Conrad Central and West Asia Department. Discussion Paper No. 1 (August 2008).

194. While the low volume of government bond issuance can be partly justified by the government budget surplus for several years on the back of robust commodity exports and strong global commodity prices, it could be argued that the present budget surplus is unlikely to be sustained indefinitely, especially in light of concerns about the outlook for the global economy. There are also examples of countries where—although the government budget was in surplus—it has been recognized that financial sector development critically depends on

79 In respect of government bond issues, the central bank acts as agent for the Ministry of Finance.
80 Uzbekistan Economic Trends 2010.
81 Uzbekistan Economic Trends 2010.

access to a deep, liquid government bond market, as this represents the risk free instrument against which other instruments are priced and hedged.[82]

ii. Corporate Bonds

195. The corporate bond market has been at a virtual standstill for several years. The market began in 1999 and, after a very slow start, issuance picked up during 2003 and 2004. There was an early peak in issuance in 2004, with 23 issues equivalent to $26 million (0.23% of GDP), bringing total bonds outstanding to $40 million (0.35% of GDP).[83] But several corporate bond issuers defaulted in 2005, after which issuance declined rapidly. There was only one corporate issue in 2006 and 2 in 2007; total volume outstanding at end 2007 fell to 0.09% of GDP.[84] In the history of the Tashkent stock exchange, it had 115 transactions from 28 issuers. In 2011, the market revived and there were three issuers for SUM70.1 billion ($39 million), accounting for 32.9% of stock exchange annual trade.

196. Defaults in 2005 exposed gaps in the regulatory and supervisory framework. To correct these, the government announced a new regulation restricting issuance to open joint stock companies that (i) satisfy pre-specified performance ratios for solvency, profitability, liquidity and financial stability over the preceding 3 years; (ii) undergo an independent audit; and (iii) obtain a rating from Abhor-Rating, the local credit rating agency.

197. At the same time, issuers are only able to issue bonds up to a total amount equivalent to their capital. This requirement appears to be impeding market development because it limits prospective issuers to relatively large enterprises, while not reflecting the issuer's ability to satisfy its debt service requirements in a timely manner. Furthermore, under the new Securities Law enacted in 2008, disclosure requirements for all open joint stock companies were extended to SMEs.[85]

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[82] The Singapore authorities actively developed the government bond market in the wake of the Asian financial crisis with a view to building the financial sector while in 2002 the Australian government was persuaded to continue issuing government bonds to support existing financial market activity.

[83] ADB. 08.2008. *Capital Markets in Central Asia* Jurgen Conrad Central and West Asia Department. Discussion Paper No. 1

[84] ADB. 08.2008. *Capital Markets in Central Asia* Jurgen Conrad Central and West Asia Department. Discussion Paper No. 1

[85] In the law it is stated that only joint stock companies with 3 years history of audited accounts can issue bonds up to an amount equal to their paid-up capital. However it is possible that SMEs may wish to issue other securities, such as equities, in which case they are subject to the same disclosure requirements as open joint stock companies.

198. As is evident from table 19 the corporate bond market grew rapidly in 2010 on the back of the Resolution[86] of the President, *On additional measures aimed to stimulate the rise in the share of long-term loans extended by commercial banks to finance investment projects*. Enactment of the resolution was a welcome step and encouraged many banks to issue long-term corporate bonds. However, although issuance volumes increased in 2010 compared to the previous two years all but one of the corporate bond issuers in 2010 was a bank, presumably in response to the resolution. That said, the largest corporate bond to date was issued in September 2011 by a nonbank enterprise. It remains to be seen whether other non-financial enterprises, particularly non-state owned enterprises, will be able to take advantage of the increased activity in the corporate bond market and issue long-dated bonds.

199. From the market's inception in 1999 to the end of December 2010 there were 137 corporate bond issues nominally valued at SUM314.3 billion[87] ($191.5 million), with issuance in 2010 of SUM229 billion ($139.6 million)—bringing the total outstanding to SUM260.7 billion (or 0.42% of GDP).[88]

200. Pricing new corporate bond issues is problematic due to the absence of a credit culture and benchmark yield curve. For example, prices are determined based on the results of an independent evaluation company followed by a market survey, which establishes the credit element of the pricing. In the absence of a benchmark yield curve, the refinancing rate is used as the pricing reference.[89] As the refinancing rate is the (penalty) interest rate at which banks borrow from the central bank when short of liquidity, its use as a reference rate for pricing corporate bonds is questionable. At the same time, several of the more recent corporate bond issues have been for longer-term maturities, making the refinancing rate inappropriate as a pricing reference.

201. Although there has been an increase in the issuance of long-dated corporate bonds, the market remains relatively immature. To minimize the mismatch risk, long-term assets should be funded through long-term liabilities, typically long-dated bond issuance. However, the market for long-dated corporate bonds is hindered by the lack of investor demand, restricting the issuance of these products. As a result, funding of long-term assets, such as mortgages, is dependent on the institution's own capital.

202. While the actual costs associated with issuing bonds are generally not considered onerous, the time taken to obtain regulatory approval is acting as a disincentive. While regulations state that applications should be processed in no more than 30 days, an acceptable time frame for a developing market, registration can take up to 3 months. At the same time, disclosure requirements for a bond issue are more extensive than for an equity issue.[90] It transpires that the regulatory approval process appears to operate along the lines of a merit system[91] rather than full disclosure.[92] Apart from lengthening the approval process, it is

86 Dated 28 July 2009.
87 Uzbekistan Economic Trends 2009 & 2010
88 Uzbekistan Economic Trends 2009 & 2010
89 Corporate bond yields compensate investors for several risks: interest rate risk (reflected in the benchmark reference), credit risk (a function of the underlying creditworthiness and reflected in the credit spread), and liquidity risk (a function of the securities' marketability).
90 This is the opposite of developed markets, where disclosure requirements for equity issues are considerably more onerous than for bond issues given the different risk profiles of the respective instruments.
91 The regulatory authorities review the substantive merits of the proposed issue to ensure that investors are protected, that is, the authorities determine the participants that may enter the market and the terms of their involvement.
92 A disclosure system builds investor awareness as it requires issuers to disclose objective, relevant, and timely information about themselves and about the securities being offered to the public.

suggested that the regulatory authorities are not best placed to review the substantive merits of a proposed capital market issue to ensure that investors are protected. Furthermore, operating a merit system compounds the problem of directed lending highlighted earlier, in that it inhibits the development of a credit culture. In addition, the Centre for Coordination and Control of Functioning of Securities Market is under-staffed with high staff turnover and has problems to retain experienced specialists.

203. Securities market infrastructure is generally considered sound, but there are concerns that the system may struggle with volume if market activity should increase. A central depository has been set up, which substantially removes the risk of fraud. Transaction processing is delivery-versus-payment, but the need to present (signed) original order documents introduces a manual element that slows the process. For example, domestic counterparties can readily transact, but it is difficult for foreign investors because orders have to be signed and original documents physically presented to brokers.

204. Clearing and settlement of corporate bonds takes place through the stock exchange.[93] Although bonds are not required to be listed on the domestic stock exchange, it is necessary for all securities transactions to be registered at a domestic stock exchange.

205. State-owned enterprises have better, that is, cheaper options for financing than issuing corporate bonds. Lending rates on commercial bank loans are only a few percentage points below corporate bond rates; however, many state-owned enterprises have access to attractively priced, that is, subsidized, loans under a government sponsored program.[94] Hence, while the issuance of corporate bonds is mostly by private companies at attractive yields, there are few private companies of sufficient size in Uzbekistan to issue bonds.

206. While the recent growth in issuance is commendable, there are concerns about the level of contingent liabilities that are building in the system as a result of the state's involvement in enterprises, both financial and non-financial. Many issuers have a level of state ownership (some as high as 100%): these same (banks) issuers are providing guarantees to other enterprises. The government is indirectly exposed to sizeable liabilities and it is not clear if such contingent liabilities are fully reflected in the government's accounts. If economic conditions deteriorate, there is a risk that there will be a substantial call on the government to fund contingent liabilities, contributing to excessive financial pressures.

b. Demand for Securities

207. The development of bond markets is critically dependent on the presence of investors across all maturities, with diverse investor groups focusing on different areas of the maturity spectrum. Differing demand can be explained by the entities' respective liabilities and the desire to minimize the risk of mismatch between assets and liabilities. Typically, mutual funds and banks therefore invest at the shorter end of the curve, out to 5 years, while insurance companies and pension funds form the core investor base for long-dated maturities—often out to 20 years.

208. At the same time, investment decisions are dependent on information about the fundamentals underlying competing assets. Investors are reluctant to commit funds, especially for long periods of time, in the absence of data. Not only is there limited information about government bonds in Uzbekistan, there also appears to be limited information about corporate

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[93] The consultant was not able to obtain any information about clearing and settlement of government bonds.
[94] Market intermediaries commented that subsidized lending was broken down into 29 categories.

bonds,[95] either *ex ante* or *ex post*. Data on outstanding issues or on trading is not sufficient to support growth of the bond market. Such lack of information limits growth potential of the investor base and the development of the bond market generally.

209. Only limited data is available on bond investors in Uzbekistan. Broadly, as of the end of 2010, banks held SUM42 billion ($25.6 million), or 79.9% of government bonds outstanding, while enterprises held the remaining securities (SUM$11 billion or $6.7 million).[96] Yields on government bonds are generally considered too low (in the order of 5.8%) and two commercial banks were routine buyers of government bonds.[97] The government does not widely communicate the possibility for institutions to buy government bonds, and awareness of this option appears limited. At present, major institutional investors are state-owned or state controlled domestic banks with other state-owned entities (firms and insurance companies) participating to a lesser extent. The government requires banks and insurance companies to hold a specified percentage of their reserves and assets, respectively, in government securities. Due to the presence of captive investors, nominal yields of government securities are very low and real interest rates are negative, that is, yields do not reflect the true status of the real economy.

210. As noted above, pension funds are key long-term bond market investors. Currently there is a two-tier pension system in Uzbekistan: (i) state provision whereby employers pay 24.8% of employees' salaries, plus an additional 4.5% of employees' salaries (withheld from the employees' salary) monthly into an extra budgetary pension fund budget, and (ii) the accumulative provision, which includes a mandatory element levied on the employee (1% of pre-tax income) and a voluntary element (employees are able to contribute up to 100% of pre-tax income).[98]

211. Halq Bank acts as an agent for the Ministry of Finance in respect of the pension fund and is responsible for operational management only. The ministry determines investment policy, with funds invested in highly liquid assets, such as bank term deposits or assets with 100% guarantee (about 90% of assets are invested in state-owned banks). Due to the low yields, funds tend not to be invested in government bonds and investment in more risky assets, such as equities and corporate bonds, is forbidden. Returns on investment are also determined by the Ministry of Finance; for example, the average return to holders of the accumulative fund in 2010 and 2011 was 8%.

212. Other institutional investors are small. The legal and regulatory framework for nonbank financial institutions is not well established and as a result these institutions, such as insurance companies, are relatively insignificant. There are 34 general insurers, but only two life insurers, the latter with relatively low market penetration.

213. Due to the absence of long-dated government bonds, it was observed that investors with long-dated liabilities—the pension fund and life-insurers—are investing in short-dated assets such as term bank deposits. The lack of long-dated assets means that these investors are taking considerable mismatch risk.

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[95] The *Law on Securities Market LRU-163 2008* requires an issue prospectus that facilities cursory due diligence. But little market information is available, such as to facilitate price discovery.

[96] Uzbekistan Economic Trends 2009 & 2010

[97] Unfortunately the consultant was not able to meet with any financial institutions that bought government bonds during the first mission.

[98] Resolution 595 sets out the framework for the accumulative scheme.

214. Government bonds are traded at the currency exchange while corporate bonds are now traded through MTS (Interbank Trading System) set up in late 2005 and operational in November 2007. However, there have been few trades. The volume of secondary market transactions for corporate bonds increased during 2005–2007, partly to compensate for reduced issuance, although there were only three trades (equivalent to $600,000) in 2007.[99] Corporate bonds used to be traded at both the main exchange and interbank,[100] but with the advent of MTS all trading moved to the interbank market. In 2010, it was reported that secondary market turnover rose substantially versus 2009 to SUM172.9 billion (about $109,000[101])—although still considerably below the turnover reported for 2007.

215. Abhor Ratings, a subsidiary of the Uzbekistan Banking Association, is the local credit rating agency. It was stated that, pursuant to a resolution to strengthen rating evaluation, methodology and analysis, the rating methodology is compliant with international standards. Sixteen local banks now have international ratings: Moody's outlook for the banking sector is 'stable'. Notwithstanding the aforementioned it is felt that there is a limited understanding of due diligence procedures. In the absence of a well developed credit culture it is likely that corporate bonds will be considered less attractive since credit risk evaluation is difficult.

2. Housing Finance

216. In Uzbekistan, about 60% of the population lives in rural areas. Within ADB´s Country Assistance Program the provision of rural housing is one of the key areas for the upcoming years. However, the current structure of the banking system does not facilitate residential mortgage lending.

217. At this stage, housing finance provision is compromised by fundamental problems in the banking sector and the securities markets. Until these issues are resolved as detailed in the previous section, it will be difficult to develop a robust housing finance market.

218. In addition there are issues specific to the provision of housing finance including that there is a lack of full enforcement of the law on property rights. Although there is a collateral registry for immovable property as yet there is no unified collateral registry for movable and immovable assets. There are also problems relating to the availability of objective property valuations, the ability of lenders to verify income and the source of deposit and title insurance.

219. Although banks have issued long-dated bonds over the past 12-months, intermediaries commented that portfolios of long-dated mortgages are funded predominantly with capital. This was not seen as a problem given the stability of share prices[102]. However in reality it predisposes to considerable risk given potential volatility in equity prices. As the market for institutional mortgage products is not developed[103] the alternative funding source is (term) bank deposits which exposes the lender to substantial interest rate and mismatch risk. The lack of long-dated funding opportunities will limit lenders' appetite for mortgage lending and restrict the range of mortgage products.

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[99] ADB. Jurgen Conrad, Central and West Asia Department. 08.2008. *Capital Markets in Central Asia. Discussion* Paper No. 1

[100] The Interbank Trading System (MTS) became operational in November 2007 as a formal online trading platform for corporate bonds.

[101] SUM/US$ 1,587.50 (ADB Key Indicators 2010).

[102] Underpinned by confidence that the government would step in to support the market in the event of any dislocation.

[103] This requires development of the long-dated corporate bond market which, to minimize risk, is dependent on the government bond market.

220. At the same time there is latent demand for long-dated assets from the pension fund and, to a lesser extent, life insurance companies. It therefore appears that there is potential to develop the market for long-dated housing finance. However, to realize this potential there needs to be a benchmark reference for pricing so that investors can accurately price the security. As outlined above, the government bond market does not currently fulfill the role of a benchmark pricing reference.

221. In conclusion, development of the market for housing finance critically depends on a range of factors, including establishing an appropriate legal framework covering immoveable assets and, importantly, building a robust, liquid government bond market.

3. Road Map for the Development of the Securities Market

222. The expected impact of technical assistance to further develop the securities market would be sustained financing of investment activities from domestic and foreign sources. The expected outcome would be expanded nonbank financing of investment activities. The technical assistance would have four outputs,[104] in which the activities can take place in parallel, through development of: (i) improved policy and consensus building, (ii) a primary market for government securities developed, (iii) secondary market for government securities developed, and (iv) a corporate bond market developed.

223. The technical assistance would assess the weaknesses and opportunities in the securities market with a view to a deeper, a more diversified nonbank financial sector that in the long-run can increase its contribution to economic growth.

224. The emphasis of output 1 of the technical assistance should be on policy development and consensus building. In this phase discussions will be needed on the direction Uzbekistan wishes to take at certain stages of development during the markets' evolution. Consultations could first take place within the government itself among the key players with an interest in the development of the bond markets. Thereafter external consultations could take place. The current technical assistance project may be helpful in kick-starting the consultation process. Yet such a process would need to be continued well beyond the end of this technical assistance as the market will be continually evolving alongside new technologies, products, and services. It will be critical for the government to remain engaged and have an active dialogue with market intermediaries and the greater financial community if it is to accurately anticipate market needs and encourage the development of the bond markets while controlling risk.

225. In the second output of the technical assistance, the development of an effective primary market for government securities would be emphasized. Activities could be focused on strengthening government cash management capability, developing a benchmark yield curve, reliance on indirect monetary policy instruments, widening the range of targeted investors beyond the banking system, and information dissemination. It is crucial for the development of the primary market to be consistent with the government's public debt management program, including issues such as its funding strategy and risk management program, as well as the central bank's policy on open market operations. The auction method for government bonds can be assessed with a view to adopting an appropriate model that can enhance the efficiency of bond issuance. Regularity, standardization, and fungibility of bond issuance should be pursued, and advantages and disadvantages of structures such as a primary dealer system should be

[104] This is consistent with the stages suggested in the Compendium of Sound Practices to Facilitate the Development of Domestic Bond Markets in APEC Member Countries. Asia-Pacific Economic Cooperation. September 1999.

considered. It should be noted that an effective primary market for government bonds is highly dependent on the timely availability of detailed facts about the government's debt management strategy and issuance calendar; such information is a critical component of intermediaries' and investors' decision making.

226. In the third output (which often overlaps with the work performed in the second output), the development of a secondary market for government securities would be the focus. Three aspects of a work program could be pursued to improve market liquidity:

(i) Enhance market infrastructure, including the legal and regulatory framework, the clearing and settlement and payment systems, the market for repurchase agreements, and bond borrowing and lending arrangements as appropriate.

(ii) Conduct a comprehensive study to first identify and then commence the process of mitigating the adverse effects of legal, regulatory, accounting, and tax impediments to investment in and trading of bonds.

(iii) Enhance the information dissemination mechanism for bonds to facilitate trading and protect investors' interests. The role of intermediaries such as market makers and inter-dealer brokers should be augmented with the objective of improving the depth and liquidity of the market. Establishment of a bond or interest rate futures market also merits consideration when the cash market has attained an adequate maturity.

227. Finally the development of an efficient corporate bond market should be emphasized. Transparency and disclosure requirements, the appropriate use of credit rating agencies, tax, and other regulatory issues should be addressed during this stage.

228. Building a roadmap for the development of the Uzbekistan securities market is complicated by the need for reform in other sectors of the economy. For example, it has been noted elsewhere that banking sector reforms are incomplete—many of the large commercial banks, for example, are still directly and indirectly owned by the state, that is, major shareholders are themselves state and state-owned enterprises. This level of state ownership impacts the institutions' ability to make wholly commercial decisions. At the same time, many nonfinancial enterprises have sizeable state shareholdings. The availability of assets that are 100% privately owned is therefore limited, with the side effect that investors are inevitably exposed to government risk.

229. Given the nascent state of the securities market and the links between this market and the real economy, it is not possible to develop a detailed roadmap at this stage. Conscious of the importance of sequencing, the methodology adopted is to set out key issues in four (sequential) phases.

Output 1: Policy Development and Consensus Building

(i) Achieve broad consensus among government agencies (State Property Committee, Ministry of Finance, and Central Bank of Uzbekistan) in respect of stated policy aims and strategy for developing securities markets.

Output 2: Development of an Effective Primary Market for Government Securities

Privatization:

(i) induce more state-owned enterprises to be listed, including both financial and nonfinancial enterprises;
(ii) strengthen and enforce minority shareholder rights;
(iii) facilitate and provide incentives for financing through the stock market; and
(iv) establish and enforce adequate corporate governance standards.

Securities market:
(i) adopt prudential regulations to strengthen market surveillance and enforcement;
(ii) review and amend securities market laws and regulations to distinguish corporate bonds from equities;
(iii) develop operating rules for the money market;
(iv) build capacity at the central bank on monetary policy instruments;
(v) review government's budgetary process and introduce a debt management office;
(vi) address weaknesses in market information dissemination;
(vii) initiate pension market reform;
(viii) enhance regulatory capacity of MoF and CCCFSM
(ix) build capacity in financial institutions for risk management and credit analysis;
(x) develop licensing examinations for securities market professionals; and
(xi) promote investor protection and education through awareness programs.

Output 3: Development of an Effective Secondary Market for Government Securities

(i) strengthen cooperation and coordination among regulators;
(ii) establish a system for systemic risk management;
(iii) encourage issuance of equity-related bonds;
(iv) initiate full disclosure-based framework for corporate bond issuance;
(v) introduce infrastructure to support shelf registration;
(vi) strengthen credit rating agency capacity;
(vii) establish appropriate legal framework covering immoveable assets;
(viii) establish uniform legal framework for fund management industry (mutual funds, investment funds, and others);
(ix) develop mutual funds;
(x) revitalize the securities industry associations as potential forerunner to a self-regulatory organizations
(xi) develop and enforce trading practices for market intermediaries; and
(xii) streamline clearing and settlement procedures to remove any manual intervention.

Output 4: Development of an Efficient Corporate Bond Market.

(i) develop markets for government bond futures and options;
(ii) adopt and enforce full-disclosure framework for corporate bond issuance;
(iii) require all financial institutions to mark-to-market;
(iv) promulgate an asset securitization law;
(v) develop framework to support investment funds; and
(vi) recognize a self-regulatory organization within the industry.

Table 20: Summary of Outputs and Activities for the Securities Market Development

Outputs	Activities
Accelerated privatization program	• Work with relevant government agencies to identify appropriate state-owned enterprises—both financial and non-financial entities. • Identify steps required to prepare candidates for corporatization.
Expanded the role of the banking sector	• Accelerate privatization of state-owned banks. • Dismantle segmented nature of banking system.
Developed government bond issuance program	• Conduct a market and regulatory diagnostic study. • Assess capacity at the relevant departments at the Ministry of Finance. • Consider implementing technical assistance project to expand debt management capabilities at the Ministry of Finance including: (i) augment cash management activities; (ii) develop strategy to introduce benchmark bond issuance program; (iii) progressively consolidate outstanding government issues with maturities longer than 3 years.
Supported development of institutional investor base (life insurance and pension sector)	• Establish legal and regulatory framework for nonbank financial institutions. • Assess market potential for life insurance • Estimate the derive demand for term insurance products including: (i) life and disability insurance (active workers); (ii) annuity products (retiring workers), and; (iii) mortgage insurance (security of repayment in event of death of borrower). • Explore the options for the entry of life insurers into the market. • Develop a regulatory regime to facilitate entry of life insurers and supervision of operations. • Develop mortality tables, and loss reserving guidelines, health insurance pricing, and others. • Implement actuarial training program. • Initiate pension reform.
Built capacity	• Identity training needs. • Provide training to develop skills of supervisory and regulatory staff. • Thereafter, provide train-the-trainer work-shops for supervisory and regulatory staff. • Collaborate with international institutions for imparting capital markets training and coaching to meet international standards.

4. Options for ADB[105] and the Government of Uzbekistan to Consider

a. Securities Market

<u>*Technical Assistance:*</u>

(i) Build capacity through training programs, study tours, and engaging resident experts. There should be focus on developing capacity at the Ministry of Finance—both debt management and government bond strategy—as well as on developing proficiency in the area of monetary policy implementation at the Central Bank of Uzbekistan.

Country Assistance Programs:

(i) Promote banking sector reform with the goal of accelerating privatization of state-owned banks and dismantling the segmented nature of the banking system to strengthen the banking sector.
(ii) Assist with the acceleration of privatization program for both financial and non-financial state-owned enterprises.
(iii) Support development and reform of institutional investor base including pensions and insurance companies.

b. Housing Finance

Technical Assistance:

(i) Promote capacity building directed at developing efficient mortgage lending practices in the banking sector. Support the development and introduction of: (a) unified standards and procedures for residential mortgage processing; (b) standard residential mortgage documentation; (c) broader range of mortgage products and d) development of concepts for rural housing.
(ii) Through training encourage cooperation between the insurance and residential mortgage lending sectors, such as (a) broaden the line of insurance products necessary for the development of residential mortgage lending, and (b) support development of standard insurance products and documentation for use in residential mortgage lending including a uniform insurance contract and policy.

Country assistance programs:

(i) Evaluate the establishment of a state-owned mortgage corporation to act as an intermediary between housing finance and the capital market, building up a secondary market and instruments of securitization.[106] This will expand the possibilities for long-term finance to the local banking systems.

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[105] There is presently no benchmark yield curve to facilitate price discovery for infrastructure bonds, mutual bonds, housing bonds or indeed any structured bonds. Typically government bonds perform this role, especially in developing markets. The problem is compounded by the lack of information or statistics on government bonds in the public domain.

[106] Frankfurt School, through its Housing Finance Competence Center, is currently developing a KfW-funded project in Mongolia for supporting the Mongolian Mortgage Corporation.

II. GOVERNMENT'S SECTOR STRATEGY

A. Current Status

230. The Government of Uzbekistan issued Presidential Resolution No. 1438 in November 2010—*On Priority Areas for Further Reforms and Sustainability Improvement of Country's Finance and Banking System in 2011–2015 and Achieving High International Ratings* (Resolution 1438). Resolution 1438 provides for:

- improvement of banks' financial sustainability and liquidity consistent with Basel Committee regulations;
- adoption of systematic measures to reinforce guarantees for depositors and further support the credibility of the banking system in the eyes of the public, including the introduction of new products and services;
- introduction of an up-to-date system rating system for the finance/banking sector in line with universal approaches to rating formulation;
- further strengthening of the legislative framework for finance and banking activities through amendments to existing or adopting new legislative and regulative instruments on the basis of international standards;
- strengthening the commercial banks capacity in the areas of project appraisal, risk assessment, and management of troubled loans;
- further stepping-up the role and network development of nonbanking financial organizations, including microcredit organizations, leasing, insurance, and audit companies, and consolidating infrastructure institutions operating in the financial market;
- encouraging development of the microfinance sector;
- strengthening accounting and reporting standards in commercial banks; and
- capacity building in commercial banks and financial institutions.

231. Resolution 1438 also approves the *Program of Priority Areas for Further Reforms and Sustainability Improvement of Country's Finance and Banking System in 2011–2015 and Achieving High International Ratings*, developed by the working group (established in accordance with President's Directive № R-3476 dd. August 6, 2010) along with the Central Bank, Ministry of Finance, Association of Banks of Uzbekistan and commercial banks. As part of an identified action plan it includes the following:

- comprehensive activities for further reforms and sustainability improvement of the country's finance and banking system in 2011–2015 and achieving high international ratings; and
- activities for further development of the microfinance and nonbanking financial sectors for 2011–2015.

232. Resolution 1438 also notes acceptance of the proposal of the Central Bank of Uzbekistan, the Association of Banks of Uzbekistan, commercial banks, and nonbanking credit organizations on phased introduction in 2011–2012 of new Basel Committee recommendations on banking supervision and measures to improve the supervision of nonbanking credit organizations that relate to:

- the capital adequacy of commercial banks;
- the formation of stabilization reserves in the capital structure of commercial banks ensuring their crisis resistance; and

- the introduction of additional mandatory economic ratios for nonbanking credit organizations.

233. There is also Presidential Resolution No. PP: 1474 of February 2011—*On the Year of Small Business and Private Entrepreneurship State Program.* [107] Its measures aim primarily at improving the enabling environment for micro and small enterprises through the reduction of bureaucratic bottlenecks and the registration and inspection requirements of micro and small enterprises' thereby reducing the transaction costs, and increasing the competitiveness of micro and small enterprise exports. [108]

234. The measures outlined in Resolutions 1438 and 1474 are directed towards addressing some of the problems of access to financial services by the low-income population, micro businesses, small farmers, and other entities. However, there is no mention of micro-insurance in either of the documents.

[107] This resolution was a part of the measures under the State Program of the Year of Small Business and Entrepreneurship.
[108] Further details can be found in ADB's Country Partnership Strategy: Uzbekistan 2012–2016, Financial Sector Assessment (August 2012).

III. ADB SECTOR EXPERIENCE AND ADB PROGRAM

A. Summary of Experience

235. ADB has been actively providing technical assistance and loans to Uzbekistan's financial sector since 1996.[109] From the start, target areas have included rural and micro and small enterprise finance. Currently, the Second Small and Micro-finance Development Project and an associated technical assistance is being implemented.[110] A loan to improve housing and enable conditions for Private Sector Participants(PSP) in rural areas was approved in August 2011.[111] In addition, the regional technical assistance, Financial Sector Development in Central and West Asia, under which this country assessment has been run prepares the ground for assistance.

236. ADB's assistance is in line with Government Resolution 1438 and will continue to contribute towards creating an enabling environment for financial sector development, therefore supporting economic growth under social and environmentally sustainable headings. Financial Sector development is part of ADB's *Strategy 2020* agenda and supplements private sector development, another of ADB's core areas of development assistance.

B. Harmonization of Activities of other Development Partners

237. ADB has closely coordinated with other donors to improve the financial sector in Uzbekistan. Sector projects include the Regional Micro-finance Project of Deutsche Gesellschaft fuer Internationale Zusammenarbeit (GIZ); the Rural Enterprise Support II project for 2008–2015 of the World Bank; the Regional Financial Infrastructure Project of the International Finance Corporation; Micro-finance Project of the UNDP; and credit lines for SME, micro and mortgage finance of Kreditanstalt für Wiederaufbau (KfW) (appendix 5).

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[109] Loan 1504-UZB for Rural Enterprise Development Project approved 17 December 1996 for $50 million; Loan 1799-UZB for Small and Medium Enterprise Development Project, approved 11 December 2000 for $50 million; Loan 1963-UZB for Small and Micro-finance Development Project approved 9 December 2002 for $20 million; Loan 2634-UZB: Second Small and Micro-finance Development Project approved 21 April 2010 for $50 million. Technical Assistance 7523-UZB: Capacity Building for Micro-finance Development (piggy-backed to Loan 2634-UZB), approved 21 April 2010 for $0.60 million. Technical Assistance 3134 Pension Reform, approved 22 December 1998 for $0.85 million. Technical Assistance 3254 Rural Savings and Credit Union Development, approved 9 September 1999 for $0.60 million. Technical Assistance 3352 Strengthening of the Banking Sector, approved 20 December 1999 for $1 million. Technical Assistance 3438 Development of the Insurance Industry, approved 11 May 2000 for $0.30 million. Technical Assistance 4121 Developing Prudential Regulation and Supervision of Savings and Credit Unions, approved 09 December 2002 for $0.40 million. Technical Assistance 4146 Development of the Capital Market approved 16 July 2003 for $0.20 million Technical Assistance 4265 Strengthening the Policy and Legal Framework for Foreign Direct Investment, approved 16 December 2003 for $0.30 million. Technical Assistance 4822 Support Banking Sector Development, approved 2 August 2006 for $0.15 million. Loan 1504-UZB; Rural Enterprise Development approved on 16 December 1998 for $50 million.

[110] Loan 2634 and Technical Assistance 7523 (2010). Micro, Small and Medium Enterprise Development Project.

[111] ADB. 2011. Project Number 44318: Report and Recommendation of the President to the Board of Directors: Proposed Mutlitranche Financing Facility Republic of Uzbekistan - Housing for Integrates Rural Development Investment Program. Manila.

238. During the mission financial institutions were met, their individual programs discussed and ADB informed them about the intended outcome of the technical assistance. UNDP, GIZ, and KfW announced their interest to continue to cooperate in the areas of micro-credit and e-commerce.

C. Focus on Nonbanking Sector

239. In the study it was discussed that in preparation for the technical assistance an ADB mission took place in May 2011, in which the government announced its preferences for ADB's activities. In coordination with World Bank and on the basis of Resolution 1438, the central bank suggested that ADB focus on the second part (Annex 2) of the action plan titled "Measures aimed at development of microfinance and nonbank financial sector". The focus of the study and the subsequent country assessment, however, focused mainly on the banking sector, discussing micro and small enterprise finance and the securities market, both of which are based on or are dominated by the banking sector. During the meeting in September 2011 the problem was flagged to the Central Bank of Uzbekistan, which did not object to ADB working on any of the subsectors. It is recommended to clarify the issue with the CBU soon.

Appendix 1: Apex Institutions in Microfinance

Fred D. Levy[1]
Key Conclusions

The Consultative Group to Assist the Poor (CGAP) publication, Apex Institutions in Microfinance by Fred D. Levy, reviews the experience of national microfinance apexes—wholesale mechanisms that channel funds, with or without supporting technical services—to retail microfinance institutions in a single country or integrated market. Here is a summary of its conclusions:

- Apexes probably expand the supply of resources available for unlicensed microfinance institutions, at least in the short term.
- However, microfinance development in most countries is held back more by a shortage of strong microfinance institutions at the retail level than by a shortage of wholesale funding.
- Planning documents for apexes typically overestimate the number of retail microfinance institutions that will be strong enough to channel the apex's funds.
- Apexes for unlicensed microfinance institutions (such as nongovernment organizations) are most likely to be useful when they are created in response to the existence of a critical mass of competent retail microfinance institutions, as was the case with Palli Karma Sahayak Foundation (PKSF) in Bangladesh.
- Apexes that fund licensed institutions such as banks and finance companies have seldom been successful in encouraging these institutions to continue micro lending when the apex money runs out. The only exceptions to this pattern seem to be where the apex's funds were linked to day-to-day technical assistance from a group that (a) had a track record of running sustainable microfinance itself, and (b) was able to provide the retail institution with a fairly complete "turnkey" package of information and management systems. The number of such technical assistance providers is very small at present.
- Apexes have not been successful in building bridges between microfinance institutions and commercial funding sources. Indeed, the incentive to seek commercial funds is weakened by the availability of easier funding from the apex.
- It may not be reasonable to require that apexes be financially sustainable themselves (after imputing a charge for the opportunity cost of their capital).
- Little evidence was found that apexes play a useful role in coordinating among donors and harmonizing their requirements.
- Management is key to an apex's effectiveness. The actual availability of managers with the necessary technical and personal qualifications should not be assumed, but rather should be investigated carefully during planning.
- The most important function of apex management is probably the selection of microfinance institutions to be funded. Because the number of qualified microfinance institutions is usually limited, managers have trouble applying proper selection criteria when they are faced with political pressure or pressure to disburse large amounts quickly.
- In the apex's supervision of the microfinance institutions it funds, focusing on institutional performance targets that are few, precisely defined, and seriously enforced is probably more effective than requiring massive reporting on detailed uses of funds.
- Political interference is a common problem in apexes, despite assurances to the contrary during planning. The best protection will usually be to keep state participation in the governance of the apex to the minimum possible.

[1] Source: Levy, Fred. Apex Institutions in Microfinance. CGAP Occasional Paper No. 6. http://www.uncdf.org/mfdl/readings/CGAPocc6.pdf

- Donors and governments tend to create unrealistic disbursement pressure for apexes. It would usually be preferable for initial funding of an apex to be modest, with larger amounts added later in response to demonstrated demand and capacity.

Appendix 2: Donor activities in Uzbekistan

World Bank

Current activities

- In the early stages of developing a financial sector action plan.
- Engaged with Ministry of Economy reforms of investment climate and is providing an SME credit line (counterparts commercial banks, looking at energy efficiency);
- The Rural Enterprise Support II project for 2008–2015
- Providing support to the reform and sustainability improvement program:
  - Collateral registry (in coordination with the International Finance Corporation)
- Development of secure transaction
  - Focus on small and medium enterprise (SME) sector
- Technical assistance for insurance sector
  - Focus on enhancing institutional capacity
  - World Bank to issue policy recommendations within the next few months
  - World Bank keen to know if Asian Development Bank will get involved.
- Private sector development
  - Enabling environment for businesses.
  - Policy recommendations will address issues in regards to access to finance.
  - Will include component on property registration which in turn feeds into property rights. (Draft legislation for property rights has commenced.)
- e-government
  - Move away from submitting information to the Central Bank of Uzbekistan in hard copy and move towards electronic transfer of information
- Technical assistance on bank supervision
  - Not yet identified areas to support

Activities in the pipeline

- Ratings agency
  - Focus is to bring banks in line with requirements for international ratings
  - Not yet decided on level of support
- Basel
  - Not yet decided on level of support

International Monetary Fund

- Article IV consultations (next consultation in November 2012)
- Public Financial Management (resident advisor)

International Finance Corporation

- Doing Business Survey includes over 200 recommendations on how to improve the business environment (for example, tax administration and reporting); Leasing (inv. in, for example, Uzbek Leasing International); credit lines to SMEs leasing; has helped amend 11 pieces of legislation to facilitate leasing; support to housing finance.
- IFC has investments in Uzbek Leasing International AO, Asaka Bank, Hamkorbank.
- Micro and Small Enterprise Support to Hamkorbank 2009 – ongoing
- Regional Financial Infrastructure Project
  - Azerbaijan, Kyrgyz Republic, Uzbekistan
- Risk certification program Global Association of Risk Professionals (GARP)
  - IFC aims to develop a program to provide GARP certification of staff in financial institutions

- Providing support to the reform and sustainability improvement program
    - Collateral registry
    - Credit bureau and credit information

European Bank for Reconstruction and Development

- As of 2011, the European Bank for Reconstruction and Development activities in Uzbekistan are quite limited with only a liaison employee in Tashkent.

United Nations Development Programme

- Project on Public Finance Management:
    1. Working with the Ministry of Finance
    2. Focus is strengthening of the budget system
    3. Public procurement included in the project
    4. There is a strategy to strengthen PFM by 2017
    5. Interested to learn more about Central and West Asia Regional Department regional technical assistance on public finance management.
- Providing support to the reform and sustainability improvement program:
    - Nonbanking credit organizations Network and Range of Services:
        - Establishing credit unions and microcredit organizations throughout the country specializing on disbursement of microcredit and micro-loans to women from low-income families (UNDP and **GTZ**)
    - Microfinance:
        - Policy level focus
        - Deputy chairman of central bank is coordinator
        - Have conducted an assessment of the microfinance
        - Provide training
        - The legal framework is in place and now needs to be implemented.
    - Improvement of accounting, regulation, and supervision in nonbanking credit organizations, and introduction of information and communications technology (ICT).
        - Increasing the use of ICT nonbanking credit organizations, including development and implementation of accounting software capable to generate financial and other statements (UNDP and GTZ)
    - Advanced training for nonbanking Credit Organization Staff (subsection in reform program)
        - Arrange subject trainings and workshops on topical issues in delivering and regulating microfinance services and study tours to learn relevant best practices (UNDP and GTZ)

Deutsche Gesellschaft für Internationale Zusammenarbeit

- Regional Sustainable Economic Development
    - Project in three countries in the region: UZB, TAJ, and KGZ
- Migration and Development
    - The objectives are to (i) utilize remittances for investment, and (ii) develop financial projects to facilitate remittance flows
    - Areas include (i) mobile banking, (ii) group lending, (iii) savings accounts, (iv) investments
    - Provide training in financial literacy and entrepreneurship
    - Are conducting a survey on the demand for microinsurance, working with the Ministry of Finance on this
- Regional microfinance development

    - Countries include Uzbekistan, Tajikistan and the Kyrgyz Republic
    - Partner with central bank nonbank supervision department
    - Working with the supervisory and regulatory staff. Provided off-site training last year and will provide on-site training this year.
- Mobile banking
    - Nonbank mobile banking: Under discussion
    - Mobile banking linked to banks in the early stages of development
- Credit Bureau
    - Work with the credit bureau managed by the bankers association
    - (IFC is mainly working with National Institute of Credit Information of the Central Bank of the Republic of Uzbekistan.
- Credit guarantee fund
    - The Government of Uzbekistan has agreed to the development of a credit guarantee fund; they now need the funding. The Chamber of Commerce is to provide SUM1 million.

Kreditanstalt für Wiederaufbau

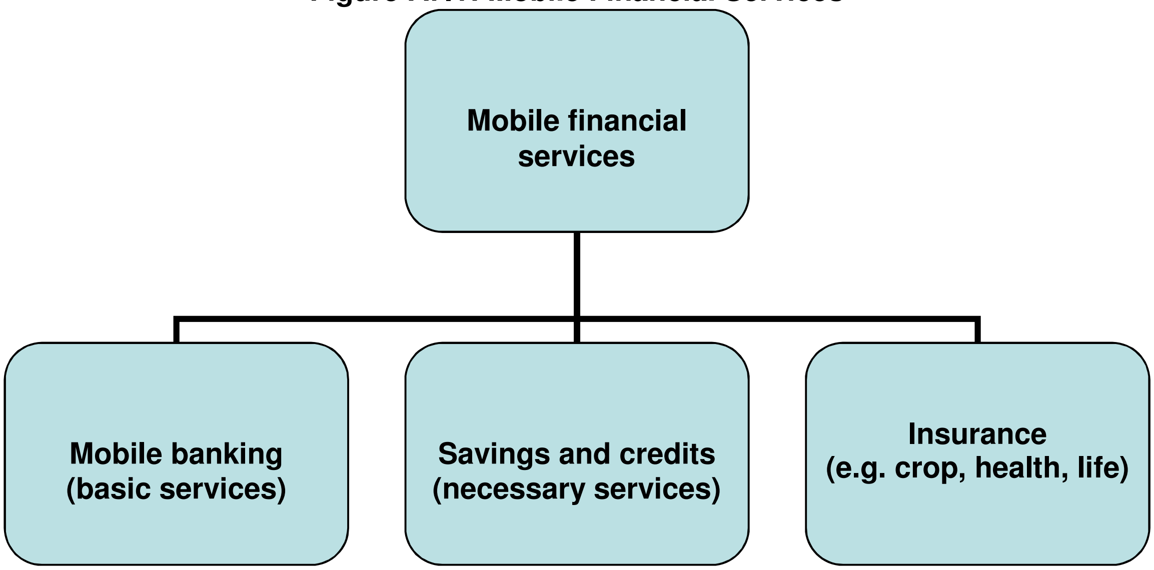
- Financial sector programs: mainly provide credit lines
    - €3 million—completed (SME focus)
    - €5 million—completed (SME focus)
    - €6 million—completed (SME focus)
    - €18.8 million—in the pipeline
        i. of which €1.5 million is for technical assistance
        ii. focus is microfinance
        iii. SME and mortgage
        iv. 4 or 5 banks will be part of this program
        v. disbursement may be in June

Appendix 3: Overview on Mobile Financial Services and a Preliminary Road Map

Background

1. The use of mobile phones to include the currently unbanked population (i.e. those who do not have access to financial services) has transformed microfinance in many countries already. In addition to providing access to banking services and adding to the convenience of customers, mobile financial services open channels to other services such as insurance and government social benefits. This is an important way forward for reaching long-term, sustainable and inclusive growth.

Figure A7.1: Mobile Financial Services



Source: Consultant

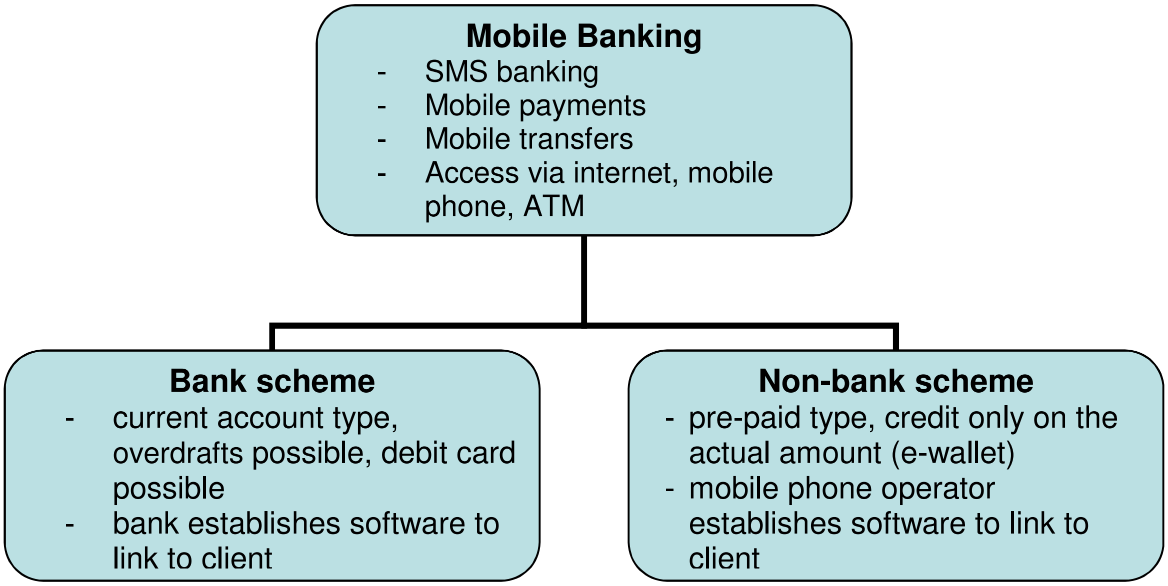
2. Banks often see mobile banking in a simplified manner as the ideal combination of a bank account and the mobile phone. The application helps banks cut operational expenses. It usually does not include other services. In a wider context, however, it is seen as a modality that provides:

- SMS banking—information such as balance inquiry, transaction receipts, and others.
- mobile payments—payment of bills and other non-cash payments; and
- mobile money transfer—initiating and receiving transfers.

3. For this study it will include the facilitation of cash-in and cash-out services. Therefore also the setting up of agent network(s) or the use of existing networks (for example minibanks or outlets of mobile phone providers) has to be analyzed.

4. Mobile banking exists in two schemes, (i) the account-based bank scheme and the (ii) prepaid card nonbank account scheme. The difference between the two is who provides the platform for the actions to be undertaken. In the bank-based system the account of the client is the anchor, which keeps its function within the bank's network for example as the salary account. In the nonbank system the client has to create a virtual account first by loading money on its mobile phone.

Figure A7.2: Mobile Banking Schemes



Source: Consultant

Bank scheme	Nonbank scheme
• many mobile phone operators can join the scheme, need to conclude contract with the bank • need for bank network, agent or ATM network to cash-in cash out • regulation under banking law • easy monitoring for government as no “parallel” market is established • savings account bear interest • costs of transaction for bank? For customer?	• mobile phone operator led scheme • mobile phone operators have to develop a system to interlink with each other, question who will take the lead (= competitive advantage); option to establish commonly used external service operator • mobile operators will on their side have to include banks for liquidity management, • mobile phone operators may have the higher trust of customers than banks, • need agent and ATM network for cash-in cash-out services, inclusion of own established shops possible, • regulation not clear, • larger multiplier effect as no account is needed, a mobile phone is already sufficient • mobile phone operators may have the wider reach though their network • costs of transaction for mobile provider? For customer?

Source: Consultant

5. There are good examples for both schemes:

Table A7.1: Worldwide Examples for Mobile Financial Services' Schemes

Bank Based	Nonbank Based
Mongolia: Amar (Xac Bank) South Africa: First National Bank Brazil: Wizzit	Kenya: Orange Money/MPesa South Africa: MTN multi-national telecommunications network

Source: Consultant

6. The successful Smart Money in the Philippines takes elements from both. While it was designed by a mobile phone operator as a nonbank-based service, it has today developed good relationships with financial institutions. This combination could be a good example for Uzbekistan as well.

7. Mobile banking can use various technologies, such as

- SMS, which is available on every mobile phone
- Unstructured Supplementary Service Data (USSD), service available from some telecoms providers which works by prompting users for input.
- Application installed on the phone, m-banking application installed on each phone that requires access. Application could be using different technology such as Android, Java.
- Application installed on the SIM card- installed by the mobile operator on the sim card. Typically used for mobile network operator (MNO) led mobile money offerings
- Browser based- access is via a web browser

8. Which one to promote depends on the penetration of mobile services in the country, cost of mobile phones and services, reliability of services and user friendliness among others. Any mobile financial service must capture measures to protect consumers and be able to set up firewalls against money laundering.

a. Mobile Financial Services in Uzbekistan

9. Mobile financial services or e-commerce in Uzbekistan is realized as part of ICT development which sets the framework to overcome the digital divide. ICT development is not seen as a goal in itself but as an instrument to improve the livelihood of the people.

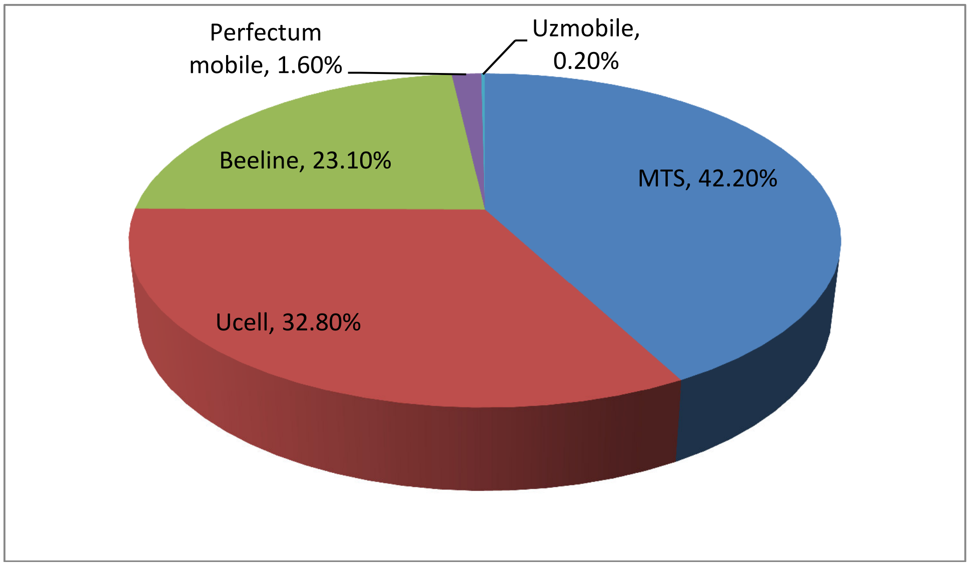
10. There is a wide range of mobile phone providers and coverage is nearly 92%.

Table A7.2: IT and Internet Development in Uzbekistan for 2000–2011

Indicator Name	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Telephone lines (per 100 people)	6.7	6.6	6.7	6.7	6.8	6.9	7.0	6.9	6.9	6.8	6.9	6.9
Mobile cellular subscriptions (per 100 people)	0.2	0.5	0.7	1.3	2.1	2.8	9.7	21.5	46.2	60.5	76.3	91.6
Internet users (per 100 people)	0.5	0.6	1.1	1.9	2.6	3.3	6.3	7.4	8.9	16.7	19.2	28.6
Fixed broadband Internet subscribers (per 100 people)	...	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.2	0.3	0.4	0.5

Source: World dataBank, World Bank (accessed November 2012)

Figure A7.3: Distribution of market shares of the biggest mobile phone providers



Note: In July 2012 the operating license of MTS's subsidiary Uzdunrobita was suspended. MTS had about 10 million clients among Uzbekistan's population of 28 million.
Source: Data of Mobile Operators "AC&M Consulting", "Avesta Research".

b. Supply of Mobile Financial Services[1]

11. Mobile payments can be conducted by several models. The following are used or being developed in Uzbekistan.

- SMS based payments (mobile phone based)
- Contactless Near Field Communication[2]
- Mobile web payment ("internet banking")

12. While "Web Money" was founded already in 1998 it was "Paynet" that in the beginning of 2006 started the field by supporting payments for a few online services. It was an outlet based service allowing only dealers to operate it. The next step was taken in 2007 when not only "Web Money" gained speed by creating a complete service including transfer of money, payments for online stores and trading of goods through internet, but also some companies were formed to promote e-commerce such as "Multisoft Solutions", "Mobile Link Services" and the payment systems "Unipay", "E-Pay", "Superkassa" and others. In the same year "Web Money" cooperated with Savdogar Bank and created an electronic account linked to a type of credit card.

13. While some of the above services did not survive due to security and other concerns, banks such as Infinbank, National Bank of Uzbekistan, PromStroyBank and Capital Bank offered internet Banking services with a limited scope. However, the attempts were also not successful.

14. Today "Web Money" and "Paynet" are the two popular payment services that survived offering a wide range of services. Paynet belonged to foreign and local private investors, but in September 2009, Khalq Bank (People's Bank) acquired 62.5% stake in the company. Foreign investors own the remaining 37.5%.

1 The following relies heavily on http://ecommercejournal.com/articles/development_of_e_commerce_in_uzbekistan_part_1.

2 Currently under development by the Chamber of Commerce and Industry of Uzbekistan with Toshiba.

15. Paynet provides the platform for the partners (mobile and internet operators, local gas firm, water provider etc) and the users, who need to pay the bills. This is done in the following manner:

1. The customer pays to the agent of Paynet: The customer goes to any agent of Paynet, specifies the recipient of the payment and the amount to be paid, and pays the amount to the agent in cash.
2. The agent pays to Paynet: Information on the accepted payment from the customer is transferred to the system of Paynet where there is a routing of data on corresponding providers. At the end of the transaction the Paynet system prints out the information to check for the customer. The agent transfers money resources into Paynet's account on the basis of the accepted payments from customers.
3. Paynet pays to the recipient: Accepted payments are also fixed in the operator's or the provider's billing. On the basis of the accepted payments, Paynet transfers the money to accounts of the corresponding operator or the provider.
4. The provider continues/activates service to customer: The client receives a message from the recipient of the payment by SMS or by internet showing the updated balance.

16. Paynet is web and desktop linked, can be accessed by mobile phones through SMS and has in addition numerous agents the customer can go to. In Tashkent alone there are approximately 5,000 and in the entire country, approximately 25,000. The "Cash collector" system functions in a real time mode, 24 hours per day, 7 days a week. Paynet has 2.25 million transactions a day of which 90% are payments for mobile providers. Paynet agents charge a commission of an average of 4% for each payment.

17. The Chamber of Commerce[3] has started another payment platform to extend e-commerce. For this it started its own company in 2004 called SSP Maroqand, with a main task to develop and implement electronic payments and prepare the respective software. The system is bank account based meaning that the payment system SMS To'lov acts as an intermediary between participating banks and their clients. The clients need to go to their bank, register with their ID, install the software on the mobile phone and receive a password. The bank also formalizes their e-signature. The client can after this operate the account from the mobile phone and the internet. The services mainly include payments of internet and mobile phone operators and some utilities. Cash is still received via a debit card. Currently SMS Tu'lov has 10,000 clients and 5 banks participate including Mikrokreditbank, Hamcor and the National Bank of Uzbekistan.

18. To broaden its services SSP Maroqand is planning to implement near-field communication as a technical specification. In case there is a receiving terminal it would allow "swiping" the mobile phone in front of a device to make payments. This method is popular in public transport, but also in convenience stores and petrol stations. Not all mobile phone are suitable, and those who are not would need to get an extra device either planted into the SIM card or on the cover of the phone.

19. Neither Paynet nor SMS To'lov have been initiated to target the currently unbanked.

20. Some banks have also started SMS banking such as Khalq Bank and Asaka Bank, which introduced SMS banking services albeit on a limited scale and Hamkor Bank which initiated e-

3 See also http://translate.google.com/translate?hl=en&sl=ru&u=http://smst.uz/&ei=2h-cTs7FJ6L74QTOkYWBBA&sa=X&oi=translate&ct=result&resnum=1&sqi=2&ved=0CDYQ7gEwAA&prev=/search%3Fq%3Dwww.smst.uz%26hl%3Den%26newwindow%3D1%26biw%3D1088%26bih%3D662%26prmd%3Dimvnsb

commerce in 2008. Neither system goes beyond the mere payment, and receiving an account statement phase.

21. It may be possible to qualify current demand by considering mobile financial services as (i) the logical development of financial services in the world benefiting those customers that have full access to banks and (ii) the rural and urban poor who are currently unbanked. Subsequently the demand takes different directions. While for the first group the "high-tech component", the ease of access and the speed with which they can conduct their private and business transactions is a top priority, however for the latter group the access to financial services is not a major concern at all.

22. In development, policy e-commerce is seen as complementary to microfinance and not as a replacement. The target is to reach poor and unbanked people. In a survey conducted by CGAP[4] in 2010 the penetration of e-commerce was confirmed: 37% of formerly unbanked people obtained access to financial services. It had also been noted that their number increased much faster than those of microfinance institutions The same study said that in the countries selected by the survey that e-commerce was only marginally cheaper than services of the microfinance organizations.

c. Government Support in Developing Mobile Financial Services

23. In 2002 the ICT development gained new impetus through the government decree "On further development of computerization and introduction of information-communication technologies" approving a new ICT strategy up to 2010. This also led to the establishment of the ICT Coordination Council which although headed by a Deputy Prime-minister consists also of Some heads of other line ministries such as education, economy, finance, trade and other stakeholders such as representatives from the industry, donors and NGOs. The composition of the Council clearly shows the cross-cutting nature of e-commerce. As the coordinating administrative body it is responsible for the development and implementation of the computerization and information-communication technologies. In 2003 an outline for the development of e-commerce was drafted which included the:

(i) Improvement of a legislative base;
(ii) Development of e-commerce infrastructure;
(iii) Development of goods and services databases;
(iv) Governmental support and incentives for e-commerce; and
(v) Implementation of pilot projects on e-commerce.

24. These were subsequently filled with quantitative and qualitative measures. In 2005 a law "on electronic payments[5]", and in 2007 a resolution "About measures on further development payments conducted under e-commerce actualization" was approved by the cabinet of ministers. Finally, in 2008 a resolution "About organization rules of payment systems, which use public telecommunications networks" was also approved. The e-commerce outline is confirmed in Resolution 1438, Annex 2 where under V. "the further development of payment systems and Infrastructure" is stipulated. E-Commerce policies make no special reference to the poor and unbanked population of the country. A general policy on ICT development has not been developed.

[4] http://www.cgap.org/p/site/c/template.rc/1.11.1025/?page
[5] Includes regulations on electronic digital signatures, electronic document flow, and others.

25. According to the Resolution 1438 a working group on e-commerce should be set in the Central Bank of Uzbekistan. The deputy chairman of the Central Bank of Uzbekistan has conveyed that the central bank is willing to work with ADB in developing e-commerce, and in establishing a working group with representatives from relevant agencies. The central bank will also facilitate discussions with the Parliament.

26. On 11 August 2011 the central bank approved the Concept on implementing ICT in Uzbek Banking system. It includes the automation of various services and the possibility of providing interactive services. Thus it once again confirms the importance Uzbekistan places in mobile financial services.

d. Conclusions for Mobile Financial Services:

- Mobile banking is at an early stage of development in Uzbekistan with the primary focus currently on convenience rather than on outreach.
- Progress made in mobile banking has not targeted the currently unbanked.
- Mobile banking is restricted by regulations, both from the banking and nonbanking sectors.
- Limitations of e-commerce in the nonbanking sector, resulting in the inability of microcredit organizations to participate in mobile banking
- Current mobile banking focuses on the part of the population that receive a salary and who have a bank account.
- Ensuring secure systems, implementing anti money laundering measures and developing consumer protection has not been not been fully addressed.
- The usage of mobile phone cards to store money to make payments and other transactions needs to be further developed: mobile phone accounts are currently topped up only for mobile phone usage and operators immediately add VAT which is accrued in operator's income statement.
- Costs of mobile banking not yet clear and well established.

2. Road map for the Development of Microfinance and Mobile Financial Services

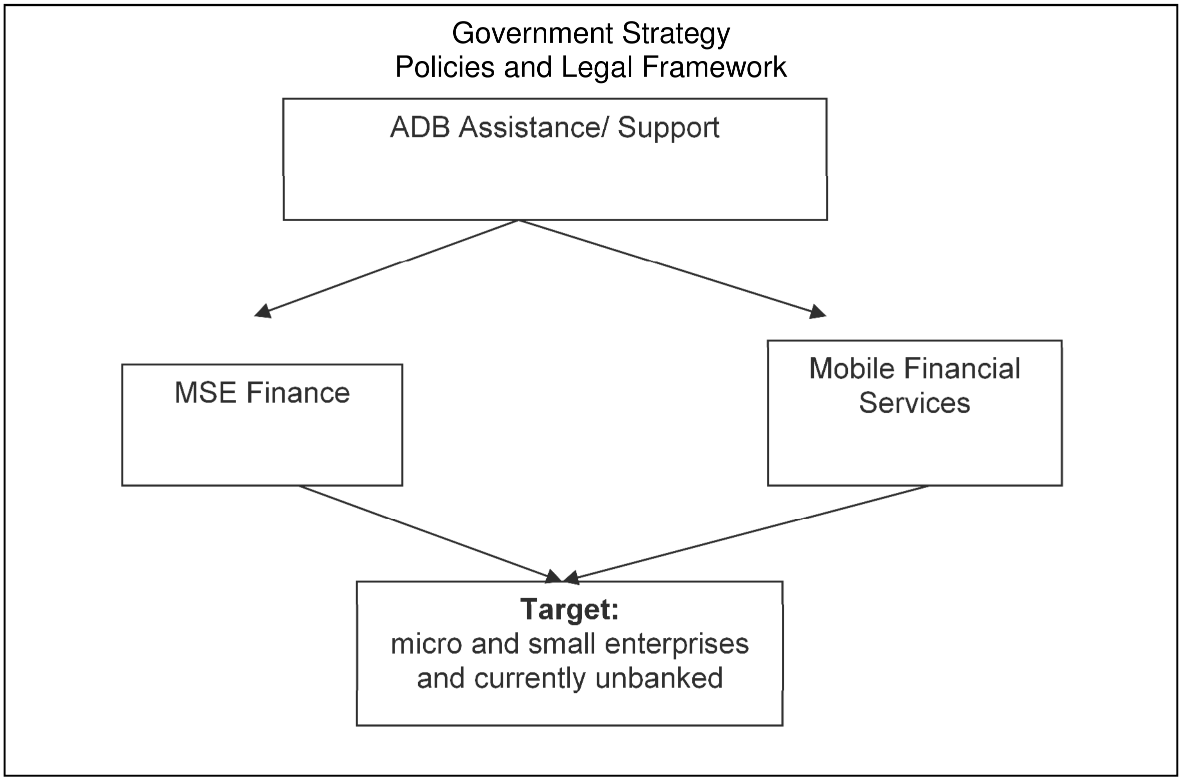
27. The overarching objective for developing mobile money transfer systems is to create opportunities to save, obtain credit and to invest. This would in turn promote employment opportunities and promote growth.

28. Given the complex situation in Uzbekistan where neither the market for microfinance is functioning satisfactory nor has mobile banking yet to leave a serious impact (as illustrated by the below figure) the way forward should

1. To strengthen microcredit organizations;
2. To set up a sustainable funding channel; and
3. To integrate mobile financial services of which mobile banking should be the first step.

29. The concept is that that these three steps while concentrating on a specific area are interlinked and some of the phases need to be done in parallel in order not to impede each other. This process has to be carefully supervised.

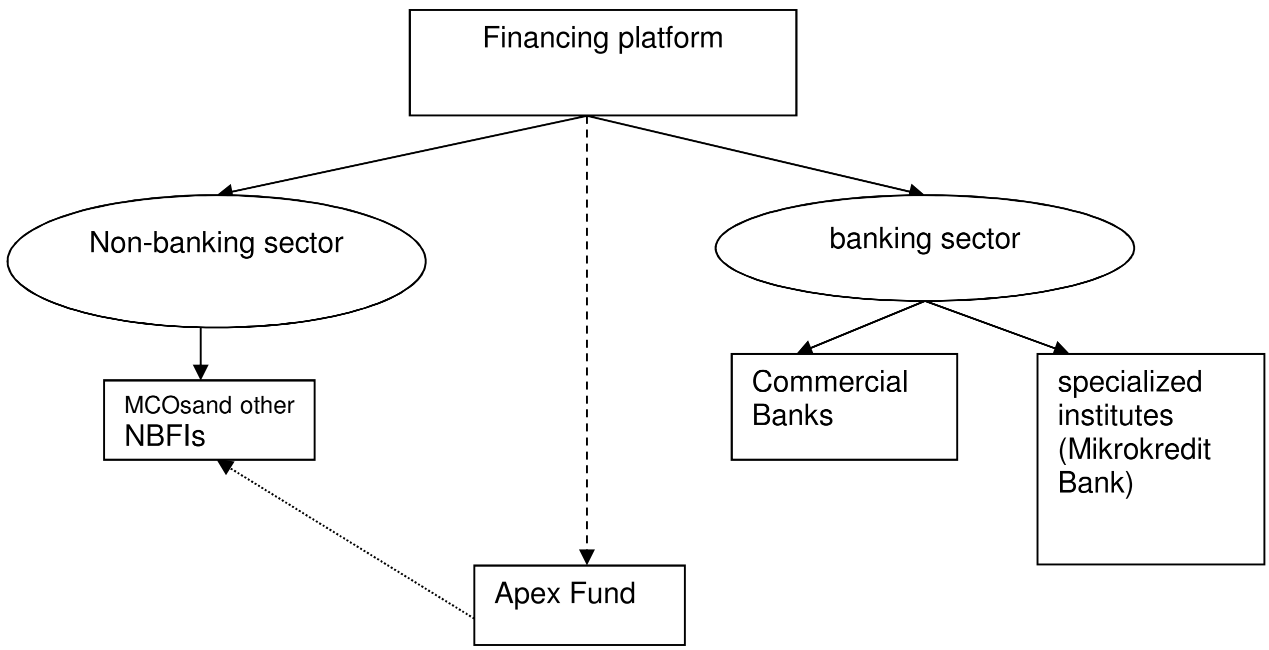
Figure A7.4: Starting Point for the Road Map



Source: Consultant (Frankfurt School of Management), 2012

30. To support micro and small enterprises and those currently unbanked, microfinance institutions are often better placed than the traditional banks. While specialized institutions can be in the banking and in the nonbanking sector, the regulatory framework under which they operate is usually different, impacting their individual approaches. This is also the case in Uzbekistan. Both platforms have substantial drawbacks when it comes to the efficiency and effectiveness of their actions to reach the target client group. Banks are currently more effective in implementing forms of mobile banking services and microfinance organizations are more successful in reaching out to the target group. Both platforms need substantial support to be able to cater for both directions.

Figure A7.5: Illustration of Funding Channels



31. According to CGAP[6] an Apex fund "is a pool of funds constituted domestically to lend to microfinance institutions that, in turn, disburse loans to low-income people. Apexes are funded with public money, but they take various institutional forms, such as development banks, nongovernmental organizations, donor programs, private commercial banks, and special government or donor programs."

32. In concurrence with the government the decision has to be taken which platform to enhance and to establish. An apex fund could be an alternative to the two existing platforms. If planned well and supported by the government it could be a powerful instrument able to provide funding to microcredit organizations, attach the full range of mobile banking services *and* stabilize the banking sector by providing best practices. Since ADB has by the government been asked to concentrate on the nonbanking sector, the road map gives attention to microcredit organizations and the Apex fund.

33. While support would be targeted at the nonbank sector with an apex fund, the banking sector could also be the beneficiary of such a fund as well. Especially in light of the several micro-credit banks the Government has suggested the commercial banks to open their may be also good opportunities. But at this stage these micro-credit banks are not yet established, why it is hard to say in which way they can be used as a platform. In any case the numerous mini banks can take on the function as agents and support the population in their mobile financial services actively.

34. In the following 3 steps are introduced containing some work packages. The steps may overlap in regard to the timing. The basic thought behind the 3 steps is to (i) establish the demand and the platform to be used for interventions; (ii) develop a possible instrument (loan) from ADB (supply of funds) and (iii) link demand and supply though mobile financial services. It

6 CPAG: Apex Brief March 2010 (see also Appendix 4)

goes without saying that while these steps have a certain sequencing changes in law and other regulations do take a long time and thus individual work pages within each step may be started in parallel.

Step 1: Strengthening the Microcredit Organizations

35. The way forward is to set-up a stable microcredit organization platform as a recipient for ADB interventions.

36. The first work package would include a review of the current regulatory framework especially those (i) which restrict the financial growth of microcredit organization, (ii) are contradictory to other regulations (also coming from the banking laws),[7] and (iii) which allow link of microcredit organization to mobile financial services. To better meet the challenges of a changing financial sector environment and to maintain financial system stability, the regulatory framework will need to move from being largely compliance based to being risk based and more forward looking with clear rules, directives and regulations for all financial institutions.

37. The second work package will focus on the capacity of current microcredit organizations that need to be strengthened. Microcredit organizations not only need to increase their capital base but also their human resource capacity through training of staff in new services, products and instruments; strengthening of management capabilities, and integration of computerized services and mobile phone based money transfer systems. Services, products and instruments provided by microcredit organizations need to be reviewed to ensure they meet the demand of both existing and potential new customers. These would include; cash and non cash loans; advisory services on for example how to establish a small enterprise In parallel, financial literacy among customers will need to be strengthened to allow them to fully benefit from the services provided.

38. The third work package needs to consider the potential benefits of establishing larger microcredit organizations through mergers and if regional preferences should be given with the aim to enhance economic growth and employment. The establishment of new microcredit organizations should also be reviewed in light of recent closures of credit unions. Some credit unions may for example consider establishing microcredit organizations as soon is the self-liquidation process allows them to do so. Such “new” microcredit organizations could reinforce the MCO sector.

39. The fourth work package would need to review remittances of migrant workers which play an important part in the lives of many people in rural areas and how microcredit organizations can be integrated.[8] Microcredit organizations should be enabled to participate in this business segment as an honest broker.

Step 2: Review of Funding Channels – Establishing an Apex

40. In the first work package the discussion with the Government has to be taken up to explore the opportunities of establishing an apex fund.

41. In parallel, as a second work package, the laws and regulations pertaining to such a fund have to be reviewed and analyzed if they are suitable for the establishment of an apex.

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7 Banks need to lend for a purpose excluding thereby the possibility to set up credit lines
8 Currently microcredit organizations are not allowed to establish depositary accounts

42. The third work package need to explore how to establish an apex fund ,what rules and regulations the apex should have, what functions should be allowed and what the overall structure should be. As in every fund it is important to consider the time frame in which it should operate and how participants can exit it. The following can be used as general guidelines:

43. Apex funds usually have two objectives:

(i) as a wholesale institution to lend to banks, microfinance institutions or others with the function of

- Screening, Selection and certification of Participating Financial Institutions (PFIs)
- Loan administration
- Liquidity management
- Credit risk management
- Foreign exchange risk management
- Monitoring
- Reporting
- Evaluation

(ii) Provide technical assistance in the form of for example

- Technical assistance and training to microcredit organizations
- Technology transfer
- Advocacy for appropriate policies
- Regulation and supervision (mostly the case in microfinance)

44. However, CGAP issued key conclusions from a micro finance report[9] of which the following lessons learned are particularly useful for the case of Uzbekistan:

1. "… *microfinance development in most countries is held back more by a shortage of strong microfinance institutions at the retail level than by a shortage of wholesale funds*." [10]

45. This seems to be the case in Uzbekistan. Given that the growth rates for MSE lending in the commercial banks is almost stagnate whereas the credit unions and microcredit organizations have seen substantial growth rates, the conclusion seems to be valid that there is enough liquidity in the system, however, it cannot be transferred properly. However, experience has shown that the dual role of apexes have often been overstretching the capacity of an apex. The balance of both is crucial as is the focus on financial intermediation.

46. Establishing an apex fund and technical assistance must be considered.

2. "*Planning documents for apexes typically overestimate the number of retail microfinance institutions that will be strong enough to channel the apex's funds*"[11] (to the end user). As discussed above microcredit organizations tend to be small and with limited capacity.

47. Absorption capacity needs to be strengthened.

3. "*Apexes that fund licensed institutions such as banks and finance companies have seldom been successful in encouraging these institutions to continue micro lending when the apex money runs out. The only exceptions to this pattern seem to be where the apex's funds were*

[9] CGAP.2008. *APEX Institutions in Microfinance* by Fred D. Levy. (see Appendix 4).
[10] CGAP.2008. *APEX Institutions in Microfinance* by Fred D. Levy. (see Appendix 4).
[11] CGAP.2008. *APEX Institutions in Microfinance* by Fred D. Levy. (see Appendix 4).

linked to day-to-day technical assistance from a group that (a) had a track record of running sustainable microfinance itself, and (b) was able to provide the retail institution with a fairly complete "turnkey" package of information and management systems. The number of such technical assistance providers is very small at present."[12]

48. Given the experience from well-performing credit unions, some competent people should be available in the market. National Association of Microfinance organizations and Credit Union (NAMOCU), an association for credit unions and microcredit organizations should be reviewed as to the merits of using the existing network.

4. "*The most important function of apex management is probably the selection of microfinance institutions to be funded. Because the number of qualified microfinance institutions is usually limited, managers have trouble applying proper selection criteria when they are faced with political pressure or pressure to disburse large amounts quickly*."[13]

- Of the currently 34 microcredit organizations only a few will be eligible for funding. The criteria for who will be eligible to receive funding will need to be carefully identified. Measures should also be in place so that those not performing satisfactorily can be disconnected from apex funds. In the beginning the number of eligible microcredit organizations is often overestimated.
- Apex loans have to be tailor made to the cash flow pattern of the microcredit organizations and not to a theoretical disbursement regime.
- Apex loans shall not create much extra reporting and monitoring burden on microcredit organizations but rather spell out, few and clear performance indicators.

5. "*Political interference is a common problem in apexes, despite assurances to the contrary at the planning stage. The best protection will usually be to keep state participation in the governance of the apex to the minimum level possible*. "[14]

- The political pressure of the government has been felt during the credit union crisis. The board, management and the supervisory board of an apex fund have to be selected with care. They must be selected for their financial and managerial skills as well as for their integrity.
- Apexes should not—if it can be avoided—be put into a bank or financial institution as independent decision making processes can be challenged.
- There seems to be a rule that a fund like an apex must be 51% Uzbeks. According to ADB public sector guidelines the borrower must be more than 50% state-owned. The set-up of the fund needs to consider both restrictions.

Step 3: Integrating Mobile Financial Services

49. The first work package relates to the legal regime: Currently the typical form of mobile banking in Uzbekistan is account based; therefore microcredit organizations are automatically precluded from providing such services as they cannot provide customers with deposit accounts under current legislation. The other option for mobile banking—mobile phone operator based—is presently not allowed in Uzbekistan. Mobile providers can provide value stored cards only for paying for their own services. If they were to take on cash payments for others they needed a banking licenses. From this point of view, neither option seems doable and it is for the government to decide which channel to open to allow inclusiveness of banking services. The

[12] CGAP. 2008. *APEX Institutions in Microfinance* by Fred D. Levy. (see Appendix 4).
[13] CGAP. 2008. *APEX Institutions in Microfinance* by Fred D. Levy. (see Appendix 4).
[14] CGAP. 2008. *APEX Institutions in Microfinance* by Fred D. Levy. (see Appendix 4).

outcome of this discussion will lead the way for the next steps and should be held on a high political level.

50. In the second work package, reliable and timely data will need to be collected to make informed decisions in regards to the quantity and quality of the market to be served and the providers of these services. It is a basic precondition without which none of the following measures is sustainable.

51. In the third work package recommendations should be made for the nonbanking sector option as the initial starting point. There seems to be consensus that so far attempts to have micro and small enterprises and the poor to open an account with a bank have failed. Why should when connecting to mobile banking services this be any different? Mobile banking will already be very alien to the target group and not present an incentive to open an account. If other countries can serve as an example it seems to be easier for the target group to go to an agent or use their own mobile phones than opening a bank account. The reasons are well known, a lack of trust in the banking system, no access to banking infrastructure, lack of information (financial illiteracy) and inadequate services. For many banks it is too expensive to open branches in remote areas servicing few people who do little amounts.

52. Thus the interface between “no service” and “bank accounts” is mobile banking services, supported by some sort of agents. The basic presumptions for this to work are that (i) some sort of agent/outlet is needed to convert cash into value on the electronic card, (ii) transactions can then be made against the value on this card and (iii) the mobile phone (= SIM card) is used to identify and authorize payments and customers.

53. The case in the Philippines shows that after using mobile banking services of a mobile phone provider the second step to open an account or to link banking to an account is more achievable.

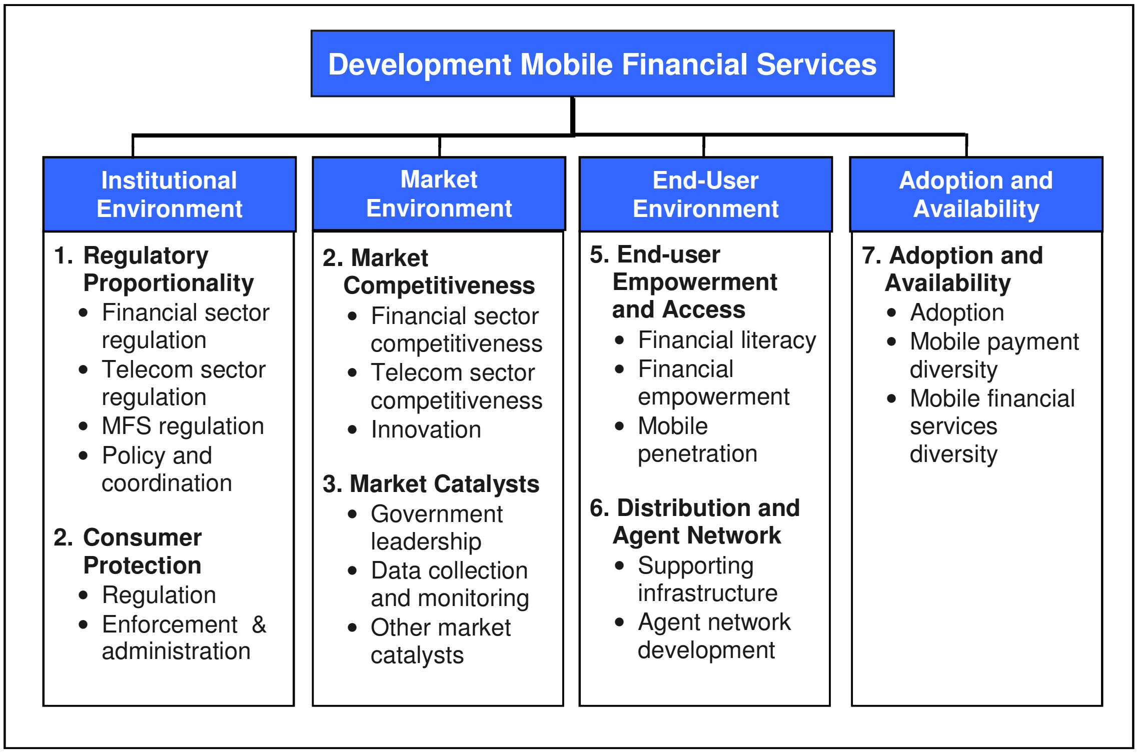
54. If necessary the provision of renewable energy components, for example agents in remote areas to operate the network in a sustainable manner, should be considered.

55. The roadmap for mobile financial services must work around three main pillars:

- Sustainability and reliability of technology;
- Trust in the local agent system; and
- Consistent end-user experience.

56. The World Economic Forum has issued in 2011 the “Mobile Financial Services Development Report”, examining 20 countries worldwide (not including Uzbekistan) to understand what are the main drivers for a “successful” model. The report uses a taxonomy and analytic structure and comes up with 7 drivers that most influence the provision of mobile financial services. They are summarized in the figure below. It is recommended to use these drivers as the analytic lamp posts around which mobile banking services in Uzbekistan should evolve.

Figure A7.6: Mobile Financial Services Development



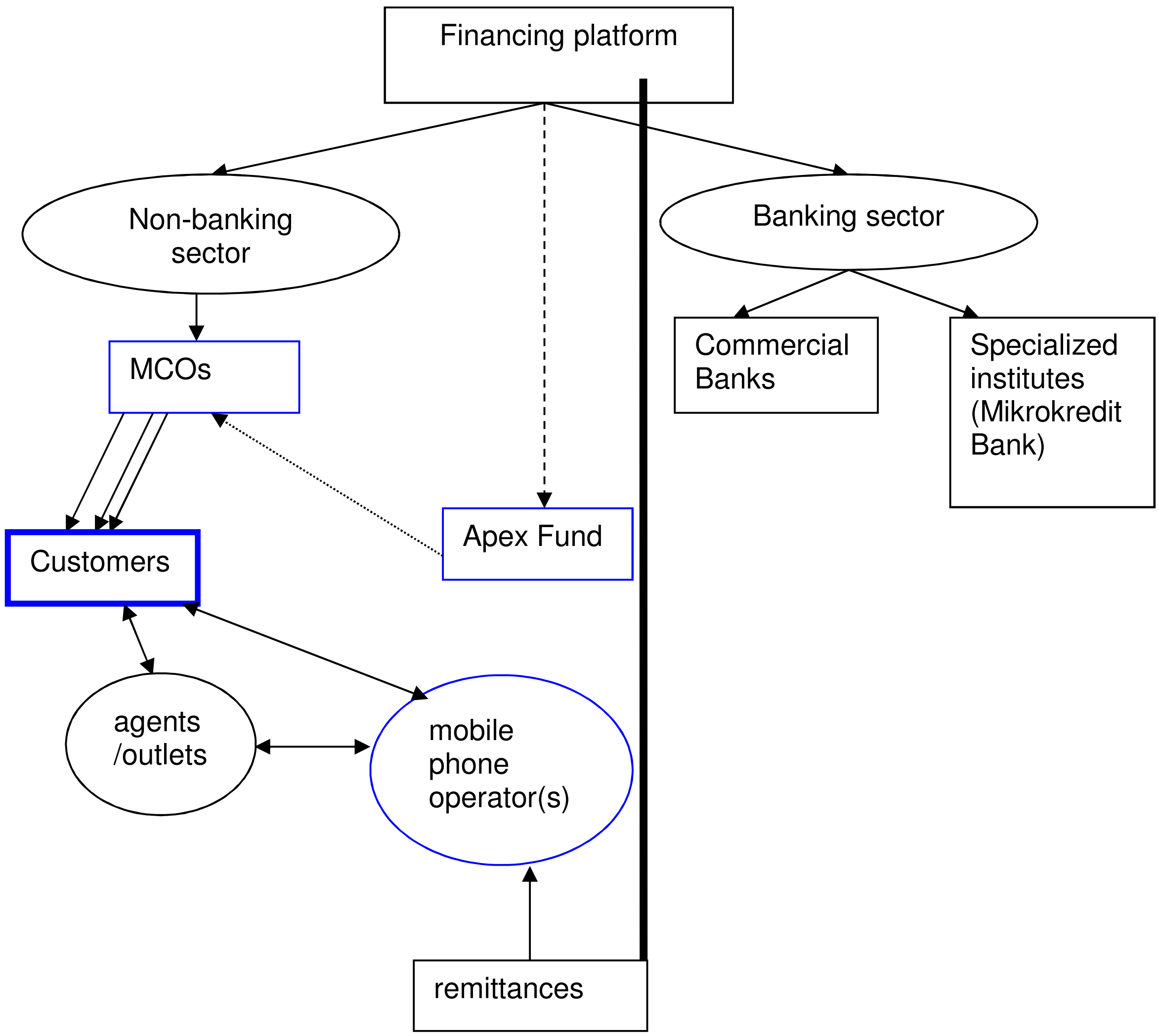
Source: World Economic Forum. 2011.

e. Conclusion for a Road Map for the Further Development of MSE Finance and Mobile Financial Services

57. It is recommended that ADB takes up discussions with the government to concur to set up technical assistance(s), to explore the strengthening of microcredit organizations, the establishment of an apex fund and the opportunities for using mobile operators as the basis for mobile financial services. While the timing of these can be in parallel the sequencing of each of the actions is crucial. Most of all the government needs to give its concurrence to the changes envisaged in the regulatory framework and the mind set behind the idea.

58. On the next page the figure concludes the findings.

Figure A7.7: Road map for MSE and Mobile Phone Based Financial Services



Source: Consultant

3. Options for ADB and the Government of Uzbekistan to Consider

Small scale technical assistance:

- Developing pilot cases for mobile banking (under review)
- Develop basic framework, governance structure, regulations for apex funds
- Capacity building of microcredit organizations and NAMOCU unions

RETA:

- In view of the overall objectives of the technical assistance strengthening of mobile financial services could be used to develop a regional component, that allows seamless money transfers
- Implementing financial literacy programs

Cross-cutting sectors:

- Consistently include a gender action plan for the various projects to be implemented

Knowledge-based products:

- E-commerce has gained importance worldwide to facilitate access to financial services for the unbanked or poorer segments of the market. In the RETA program region, this factor is rather underrepresented. Thus, further fact finding could be done about the opportunity to create a region-wide working paper about the role of e-commerce

facilitating access to financial services and the opportunities for ADB to support financial inclusion in the region (outside the Uzbekistan country assessment)