

ASIAN DEVELOPMENT BANK

TAR:UZB 33500

TECHNICAL ASSISTANCE

TO THE

REPUBLIC OF UZBEKISTAN

FOR THE

STRENGTHENING OF THE BANKING SECTOR

December 1999

CURRENCY EQUIVALENTS

(as of 15 December 1999)

| | | |
|---------------|---|------------|
| Currency Unit | — | SUM |
| SUM1 | = | \$0.007187 |
| \$1.00 | = | SUM139.14 |

ABBREVIATIONS

| | | |
|----------|---|--|
| ADB | — | Asian Development Bank |
| CBU | — | Central Bank of Uzbekistan |
| EU-TACIS | — | European Union Technical Assistance for the Commonwealth of Independent States |
| FSU | — | former Soviet Union |
| IAS | — | International Accounting Standards |
| IMF | — | International Monetary Fund |
| MOF | — | Ministry of Finance |
| TA | — | technical assistance |
| UBA | — | Uzbekistan Banking Association |

NOTES

- (i) The fiscal year of the Government ends on 31 December.
- (ii) In this report, "\$" refers to US dollars.

I. INTRODUCTION

1. The Government of the Republic of Uzbekistan has recognized the urgency of developing a sound and well-regulated banking sector that emphasizes efficiency and market orientation, which can better withstand crises and challenges. The Government plans to accomplish this by (i) developing a holistic banking reform strategy to strengthen banking regulation and supervision, encourage commercial banks to make objective commercial and financial decisions, and design approaches to improve portfolio quality and intermediation process; and (ii) converting selected sector-specific banks to universal commercial banks in line with international best practices, as a prelude to their ultimate privatization. In June 1999, the Government requested for technical assistance (TA) for (i) developing a banking sector reform strategy and its implementation plan, and (ii) supporting the conversion of Paktha Bank and Mevasabsavot Bank to universal commercial banks.¹ A Fact-finding Mission visited Uzbekistan between 2 and 9 September 1999 to firm up understanding on the objectives, scope, cost, financing, and implementation arrangements for the TA. The TA's logical framework is in Appendix 1.

II. BACKGROUND AND RATIONALE

2. Uzbekistan inherited from the former Soviet Union (FSU) an economic system based on centralized planning of production and control of resources. In Soviet times, the State Planning Authority financed activities in line with the State's production targets, and commercial banks lent for this purpose. The banks had no independent lending decision-making powers; their capacity for risk management, credit appraisal, or project selection was extremely weak; and they lacked effective techniques for assessing income generation and solvency of borrowers. Weaknesses in the Central Bank's monetary policy management and banking supervision distorted credit allocation and pricing mechanisms. Banks' financial statements' disclosures were limited. Banks were assigned the dual role of tax assessors and collectors on depositors' incomes. In the late 1980s, several new banks were established by state-owned industrial and agricultural enterprises of the FSU. This trend continued after Uzbekistan's independence in 1991. Most state-owned commercial banks were sector specific in their operations. They sought public deposits but concentrated lending to their owners. Banks carried significant credit risks amidst a weak institutional environment for debt recovery. These factors over time resulted in the accumulation of a large amount of nonperforming loans.

3. Since 1995 and more so after the Asian and Russian financial crises, the Government has recognized the need to launch broad-ranging banking reforms. Accordingly, the Government (i) introduced an electronic automated payments, clearing and settlement system between the Central Bank and commercial banks in 1995; (ii) introduced a two-tier banking system² and separated functions between the Central Bank and commercial banks; (iii) strengthened the Central Bank's regulatory and supervisory role in 1996 by requiring commercial banks' adherence to prudential norms, classification of their loan portfolio on the basis of collectibility, and adequate provisioning for nonperforming loans; and (iv) introduced in 1997 new bank accounting and disclosure standards consistent with international standards.³ In addition, a presidential decree was passed in October 1998 to improve the management of joint-stock banks. This was followed by the adoption of a few resolutions of the Cabinet of Ministers in January 1999 that aim to improve competition among banks and provide for the conversion of sector-specific banks to universal commercial banks.

¹ The TA first appeared in *ADB Business Opportunities* in September 1999.

² By the enactment of the Central Bank Law in 1995, and the Law on Banks and Banking Activity in 1996.

³ Banks have moved to a double-entry accrual accounting system. However, they have not fully adopted International Accounting Standards (IAS).

4. The Government is keen to gradually expand financial sector reforms. For this purpose, it has approached a number of aid agencies including the International Monetary Fund (IMF), World Bank, and European Union Technical Assistance for the Commonwealth of Independent States (EU-TACIS) to provide support in different areas. The IMF, as part of its consultation, has been assisting in (i) the Central Bank of Uzbekistan's (CBU's) internal reorganization, (ii) improving banking legislation, (iii) preparing banking sector regulatory and supervision codes, and (iv) conducting diagnostic audits of commercial banks. The World Bank approved a large TA loan in May 1999⁴ to (i) strengthen CBU's management information and payments system; (ii) support the 1999 and 2000 audits of the country's commercial banks by international audit firms to determine among other things, their compliance with the IAS; and (iii) develop a strategy for restructuring the loan portfolios and institutional strengthening of five banks.⁵ The EU-TACIS provided TA in 1996,⁶ to (i) develop the charter of the Uzbekistan Banking Association (UBA), (ii) upgrade the library and computer facilities of the Banking and Finance Academy, and (iii) provide advisory services to commercial banks, including broad exposure to international best practices.

5. ADB has now been approached to expand its support in the banking sector to assist (i) the development and implementation of a banking sector reform strategy, and (ii) institutional strengthening of two banks to facilitate their conversion to universal commercial banks. This builds further on ADB's past TA program which included two country-specific TAs and two regional TAs. The former helped (i) the National Bank of Uzbekistan, which hitherto had concentrated on trade financing, diversify in project financing and build appraisal capacity;⁷ and (ii) the Regional Banking Training Center and the Banking and Finance Academy train the trainers in the international banking practices and offer special out-of-country training to middle- to senior-level bankers.⁸ The first regional TA provided banking regulators and supervisors with basic training in the principles of banking supervision in a market economy.⁹ The second regional TA helped modernize commercial bank credit management and operational systems in transitional economies.¹⁰

6. The TAs of the World Bank and EU-TACIS have not specifically focussed on (i) issues of CBU's monetary policy, interest rate administration, directed lending and treasury bills operations; (ii) restructuring of other state-owned banks than those listed in footnote 5; (iii) credit appraisal and risk management; (iv) corporate governance of banks; (v) fiscal consequences of bank restructuring; and (vi) implementation of best practices in banking regulation and supervision. ADB's new TA will complement the work sponsored by the IMF, World Bank, and EU-TACIS by addressing the above areas. It will support and facilitate the (i) development of a banking sector reform strategy drawing on results of past TAs including the audit of commercial banks, and recommending an action plan for the introduction of sound regulatory and governance practices at both central bank and commercial bank level; and (ii) introduction of best international practices in credit appraisal, risk management, internal control, and financial disclosure policies to two selected state-owned banks.

⁴ UZ: PE 9131: *Financial Institution Building Project*, for \$25 million, approved on 27 May 1999.

⁵ Asaka Bank, UzpromstroiBank, Ipak Yoli Bank, Andizhan Bank, and Uzhilsber Bank.

⁶ FINUZ 96-01: *Support for Commercial Banking Sector*, for ECU1.6 million, approved in November 1996.

⁷ TA 2714-UZB: *Institutional Strengthening of National Bank of Uzbekistan*, for \$830,000, approved on 17 December 1996.

⁸ TA 3045-UZB: *Developing Commercial Banking Skills*, for \$1,000,000, approved on 10 July 1998.

⁹ TA 5699-REG: *Strengthening Banking Capabilities in Transition Economies in Asia*, for \$885,000, approved on 27 August 1996.

¹⁰ TA 5821-REG: *Strengthening Commercial Banking Skills in Transition Economies Asia*, for \$970,000, approved on 22 December 1998.

7. The TA is consistent with ADB's proposed new country operational strategy for Uzbekistan, which supports policy reforms and capacity building to facilitate the orderly transition from a centrally planned to a market economy. The new strategy recognizes the importance of a financially sound and viable banking system, which can promote efficient financial intermediation, and calls for ADB's participation in financial sector reforms. Efficient financial intermediation is necessary to mobilize public savings and use them to finance activities in which the country has a comparative advantage. ADB's earlier two TAs to Uzbekistan's banking sector were essentially geared toward capacity building and providing commercial bankers with training in best practices of commercial banking at the basic level. This TA has a broader objective and scope, and aims to develop a policy reform agenda for the banking sector, while assisting in selective implementation of these reforms by supporting institutional strengthening and commercialization of two banks.

8. The banking reform strategy and the analytical work to be undertaken to support restructuring of the two banks under this TA will feed into ADB's policy dialogue in the financial sector. The background work undertaken will help in formulating a comprehensive policy package for banking sector reforms for a potential program lending operation and upgrading the technical capabilities of two selected commercial banks to efficiently carry on lending.

III. THE TECHNICAL ASSISTANCE

A. Objectives

9. The overall goal of the TA is to (i) strengthen efficiency, market-orientation, and stability of the banking sector; (ii) improve intermediation; and (iii) facilitate the timely flow of credit without distortion in pricing or delivery to those sectors in which the country has a comparative advantage. This is to be achieved by (i) development of a banking sector reform strategy and implementation plan; and (ii) introduction in two commercial banks of international best practices to facilitate their conversion to universal commercial banks as a prelude to their ultimate privatization. By promoting improved financial intermediation and corporate governance at the microlevel for two banks, the latter component will demonstrate a broad-based enhancement of the quality of financial intermediation throughout the banking sector. The output of the TA will set the stage for further banking sector reforms in Uzbekistan.

B. Scope

1. Part A: Banking Sector Reform and Restructuring

10. The TA will support a comprehensive evaluation of the banking sector and lay the foundation for a sound, efficient, well-regulated, modern banking sector that can better withstand challenges and crises. The TA will provide (i) a diagnosis of the banking sector, identifying the strengths and weaknesses of its various segments; (ii) an action plan laying down the pace and sequence of reforms over the short, medium, and longer terms; and (iii) policies and administrative measures required to facilitate the implementation of the action plan. This component will cover linkages and synergies between monetary and banking sector policies and capital markets. It will also recommend measures to (i) improve CBU's regulatory and supervisory role in allocating and pricing credit; (ii) improve interbank competition; (iii) abolish the role of banks as tax assessors; and (iv) improve the financial disclosure, corporate governance, and regulatory submissions in the sector.

2. Part B: Facilitating Conversion of Pakhta Bank and Mevasabsavot Bank to Universal Commercial Banks

11. This component will introduce in Pakhta Bank and Mevasabsavot Bank best practices in credit appraisal, risk management, and corporate governance. In improving credit appraisal capabilities, the TA will concentrate on (i) loan quality (from the perspectives of repayment and collateral enforcement); (ii) internal controls in credit processing; and (iii) credit diversification and single borrowers exposure limits. In improving risk management, the TA will address the issues of credit risk, exchange risk, interest rate risk, and counterparty risk. In improving corporate governance, the TA will enhance transparency in financial disclosure by banks and their internal supervision by their boards. Internal reforms and restructuring of these two banks are necessary to facilitate their transformation to universal commercial banks as a prelude to their privatization.

12. The consultants for component B will closely coordinate and draw on the work undertaken under the World Bank's TA loan. To ensure that the banking sector reform strategy formulated under component A is consistent with and relevant to the prevailing practical situation in Uzbekistan's banking sector, the team leader of Part A will closely interact with team leader of Part B and integrate the findings of Part B. UBA will be responsible for the overall coordination.

C. Implementation Arrangements

13. UBA will be the Executing Agency for the TA. UBA is a statutory legal entity established under a Government decree and represents the interests of all the country's commercial banks.¹¹ UBA's charter requires it to (i) assist commercial banks in deepening economic reforms, (ii) establish a modern banking infrastructure of international standards, and (iii) assist commercial banks in independent decision making in accordance with best international practice. UBA's senior management comprises individuals with practical commercial banking and legal experience. UBA is facilitating the conversion of all its member banks into universal commercial ones and will use this TA as a pilot demonstration project for assisting other sector-specific banks among its members in doing so. UBA has the necessary infrastructure and funding to be the EA for this TA. It will establish a special TA coordinating committee, comprising representatives from UBA, Ministry of Finance, CBU, Pakhta Bank, and Mevasabsavot Bank, to monitor the implementation of the TA. UBA will provide necessary logistical support for TA implementation. The Government will ensure that the consultants are provided the necessary information for undertaking their terms of reference for both components of the TA.

14. The TA will be implemented over a period of nine months and will involve a total of 44 person-months consulting services: 20 international and 24 domestic. The consultants' areas of expertise are indicated in Appendix 2. The 14 person-months (8 international and 6 domestic) for Part A will be implemented by three individual consultants (two international and one domestic) selected in accordance with ADB's *Guidelines on the Use of Consultants* and other arrangements satisfactory to ADB for the selection of domestic consultants. The implementation of this component will commence in January 2000 and end in September 2000. Part B involving 30 person-months (12 international and 18 domestic) will commence in March 2000 and end in September 2000. A firm of international consultants will be selected to provide a five-person team for this purpose. The international firm will be selected using the simplified technical proposal in accordance with ADB's *Guidelines on the Use of Consultants* and other arrangements satisfactory to ADB for the selection of domestic consultants. The reporting arrangements under the TA are described in Appendix 2. All

¹¹ UBA was incorporated on 28 July 1995 with 24 member banks. In September 1999, it had 33 member banks and was chaired by the Minister of Finance.

procurement financed under the TA will be carried out by the international consultants in accordance with ADB's *Guidelines for Procurement*.

D. Cost Estimates and Financing Plan

15. The cost of the TA is estimated at \$1,117,000 equivalent, comprising a foreign exchange cost of \$910,000 and a local currency cost of \$207,000 equivalent (Appendix 3). The Government has requested an ADB grant of \$1,000,000 equivalent, to cover the entire foreign exchange cost and \$90,000 equivalent of the local currency cost. The TA will be financed by the ADB on a grant basis from the ADB-funded TA program. UBA will finance the remaining \$117,000 equivalent in local currency costs in kind through the provision of office space, local counterpart staff, seminar, training facilities, and local transportation. UBA will recover its costs from the two banks in separate and mutually satisfactory arrangements with them.

IV. THE PRESIDENT'S DECISION

16. The President, acting under the authority delegated by the Board, has approved the provision of the technical assistance, on a grant basis, to the Government of the Republic of Uzbekistan in an amount not exceeding the equivalent of \$1,000,000, for the purposes of Strengthening of the Banking Sector, and hereby reports such action to the Board

TECHNICAL ASSISTANCE FRAMEWORK

| Design Summary | Targets | Monitoring Mechanisms | Risks and Assumptions |
|--|---|---|--|
| I. Sector/Area Goal | | | |
| <p>1.1 Promote the development of an efficient banking sector to intermediate between savers and investors</p> <p>1.2 Identify road map for addressing distortions in the banking system, and strengthen prudential banking supervision and governance</p> <p>1.3. Facilitate the timely flow of credit to those sectors in which the country has comparative advantage</p> | <ul style="list-style-type: none"> • Development of an efficient and market-oriented banking sector • Time-bound policy measures for elimination of distortions and strengthened banking supervision • Elimination of distortions, if any, in the delivery and pricing of credit in the financial intermediation process | <ul style="list-style-type: none"> • ADB and World Bank sector studies relevant to Uzbekistan's banking sector • Policy dialogue with the Government of Uzbekistan on a road map for the removal of all distortions in the banking sector | <ul style="list-style-type: none"> • The Government's continued commitment to an efficient and market-based banking sector |
| II. Purpose/Objectives | | | |
| <p>2. Strengthen the mechanisms for an efficient and market-oriented banking sector by (i) developing an agenda for banking sector reforms that concentrate on the elimination of distortions, and (ii) the introduction in two commercial banks of international best practices in credit appraisal, internal control, systems and risk management, and transparent financial disclosure policies, to facilitate their conversion to universal commercial banks as a prelude to their privatization</p> | <ul style="list-style-type: none"> • Establishment of a reform agenda for the country's banking sector • Establishment over the next three years of financially strong universal commercial banks with a balanced and high quality portfolio (so that concentration to any sector does not exceed 20 percent of total portfolio) following international best practices in (i) credit appraisal, procedures, documentation, and supervision; (ii) internal control; (iii) risk management; and (iv) financial disclosure policies; as a prelude to their ultimate privatization | <ul style="list-style-type: none"> • TA Inception Mission will ensure that the TA's objectives are well understood • TA review missions • Tripartite meetings • Consultants' interim and mid-term reports | <ul style="list-style-type: none"> • Good coordination between the Uzbekistan Banking Association (UBA), the Executing Agency for the TA, the consultants, Paktha Bank, and Mevasabsavot Bank • Timely inputs from Paktha Bank and Mevasabsavot Bank |
| III. Outputs | | | |
| <p>3.1 Provide consulting services in (i) developing a reform agenda for the banking sector;</p> | <ul style="list-style-type: none"> • Road map for reform of banking system | <ul style="list-style-type: none"> • TA review missions | <ul style="list-style-type: none"> • Continued Government support to banking sector reforms |

| Design Summary | Targets | Monitoring Mechanisms | Risks and Assumptions |
|--|--|--|---|
| <p>(ii) improving banks' credit appraisal;</p> <p>(iii) improving banks' credit approval and documentation procedures and post-disbursement monitoring, and recovery;</p> <p>(iv) improving banks' internal control systems;</p> <p>(v) improving banks' risk management systems;</p> <p>(vi) improving transparency and timeliness of banks' financial disclosures.</p> | <ul style="list-style-type: none"> Improved credit appraisal system necessary for universal commercial banks operating under market principles Complete acceptance of TA's recommendations for improved bank credit administration and reporting system Improved and better balanced bank loan portfolio with no individual subsector accounting for more than 10 percent of the total loan portfolio of the banks Complete acceptance of the TA's recommendations for improved bank internal control systems with adequate checks and balances Establishment of bank risk management systems in accordance with international practices Quarterly publication of the banks' financial results from 2000 onwards Improved transparency in disclosure by disclosing policies on income accrual, portfolio classification, and loan loss provisions from 2000 onwards | <ul style="list-style-type: none"> Progress reports from consultants Tripartite meetings. Consultations and coordination with other aid-agencies Policy dialogue with Government | <ul style="list-style-type: none"> Willingness of two commercial banks to undertake reforms recommended under the TA |

| Design Summary | Targets | Monitoring Mechanisms | Risks and Assumptions |
|--|---|--|---|
| IV. Activities/Inputs | | | |
| <p>(i) Reform agenda for the banking sector concentrating on the need for eliminating distortions</p> <p>(ii) Credit appraisal, approval, documentation, collateral investigation, registration and valuation, credit concentration ratios (sectorally and borrower-wise), and post-disbursement recovery</p> <p>(iii) Introduction of appropriate information technology in enhancing banks' credit functions [listed in (i) to (ii) above]</p> <p>(iv) Banks' internal control, internal audit, and risk management systems</p> <p>(v) Bank boards' supervision of banks' activities and the quality, reliability, and timeliness of information furnished to the Board</p> <p>(vi) Banks' internal checks and balances to ensure their staffs' adherence to fiduciary responsibilities</p> <p>(vii) Transparency in financial disclosures and improving the frequency and timeliness of their reporting</p> | <ul style="list-style-type: none"> • \$1,000,000 TA assistance • 8 consultants (44 person-months) | <ul style="list-style-type: none"> • TA review missions • Consultants' reports • Consultation and coordination with other aid-agencies • Policy dialogue with Government | <ul style="list-style-type: none"> • Availability of counterpart support • Full cooperation between consultants and counterpart staff |

ADB = Asian Development Bank, TA = Technical Assistance.

TERMS OF REFERENCE FOR CONSULTING SERVICES

A. Introduction

1. The technical assistance (TA) will be implemented over a nine-month period and will involve 44 person-months of consulting services (20 international and 24 domestic).

2. Part A (14 person-months) will be implemented by a three-member team of two international consultants and one domestic consultant to be selected in accordance with the Asian Development Bank's (ADB's) *Guidelines on the Use of Consultants*. The implementation of this component will commence in January 2000 and end in September 2000. The team leader (international consultant) for this component will be an expert in banking sector restructuring strategies. He/she will have had substantial experience in bank restructuring, particularly in the transformation from an activist regulatory regime to a prudential supervisory system. The team leader will provide 6 person-months' service and will be responsible for the output of the team. The team leader will be assisted by (i) an international banking and governance specialist (2 person-months), and (ii) a domestic reforms, restructuring, and governance specialist (6 person-months).

3. Part B (30 person-months input) will be implemented by a five-person team. The team leader will be an international banking credit and risk management specialist with substantial experience in these disciplines with one or more major and reputable international banks. The team leader will provide 6 person-months consultancy and will be responsible for the output of the entire team. The team leader will be assisted by (i) an international bank accounting, internal controls and corporate governance specialist (6 person-months), and (ii) three domestic consultants (each for 6 person-months). One of the domestic consultants will be a bank credit appraisal expert. The second will be a bank risk management expert. The third will be a bank accounting, internal control, and corporate governance expert. The implementation of this component will begin in March 2000 and end in September 2000. A firm of international consultants will be selected for this component in accordance with ADB's *Guidelines on the Use of Consultants*. The consultants under component B will closely coordinate and draw on the work undertaken under the World Bank's TA loan. To ensure that the banking sector reform strategy formulated under component A is consistent with and relevant to the prevailing practical situation in Uzbekistan's banking sector, the team leader of component A will closely interact with team leader of component B and integrate the findings of component B.

B. Reporting Requirements

4. Within one month of commencement of the TA, the consultants will submit an inception report to ADB, Ministry of Finance (MOF), Central Bank of Uzbekistan (CBU), Uzbekistan Banking Association (UBA), Pakhta Bank, and Mevasabsavot Bank. This report will cover the planned TA implementation schedule, anticipated issues and problems, and ways of resolving them. At the end of the first phase (about 100 days after the commencement of the TA), the consultants will submit an interim report. When the special Banking Restructuring Unit is established in MOF, the consultants under component A will also report to that unit in addition to the coordination committee.¹ Thirty days before the conclusion of their work, the consultants will prepare a draft final report that will integrate the findings and recommendations from each expert. The draft will be discussed at a tripartite meeting involving representatives from ADB,

¹ A special Banking Restructuring Unit is to be established in the Ministry of Finance in early 2000 to address the problems of State-owned banks in Uzbekistan.

MOF, CBU, UBA, Pakhta Bank, and Mevasabsavot Bank. The final report, incorporating the recommendations, will be submitted within two weeks after the tripartite meeting (an English version to ADB and a Russian version to the other parties).

C. Expertise Required and Job Description

1. Part A

a. Team Leader/Banking Sector Reforms and Restructuring Specialist (6 person-months)

5. The team leader will have had at least five years experience in banking sector reforms and restructuring of banks, preferably during the change from a activist regulatory regime to one of prudential supervision. The consultant should have at least a master's degree in economics, preferably with 10 years experience in banking supervision and regulation in a developed market economy. Prior experience in former centrally planned economies in transition is highly desirable.

6. An in-depth analysis of the present status should be the starting point for this component. The analysis should take into account the current problems in the country's banking sector. The analyses and recommendations should discuss the sequencing and phasing of reforms and transition issues. Further, in preparing a banking sector reform strategy, a necessary starting point is to undertake projections of supply/demand, business opportunities, and strategic steps to capitalize on those opportunities (including a discussion of the sequencing of the recommended steps).

7. The consultant will assume overall responsibility for (i) projection of supply/demand for credit and business opportunities for use of bank credit, and preparation of strategic steps to realize those opportunities; (ii) review of the regulatory and supervisory system in place, with recommendations that will enhance its effectiveness; and (iii) assessment of the current competitiveness of the banking system and recommendations on the means to enhance it.

8. Specifically, the consultant will study (i) a diagnostic review of the current health of the banking system identifying its strengths and weaknesses; (ii) adequacy of prudential standards; (iii) fiscal implications of bank restructuring; (iv) current status of banking sector facilities and instruments, e.g., trade financing, discounting, etc.; (v) adequacy of financial market infrastructure for CBU's treasury bills operations; (vi) role and conduct of the Central Bank in monetary policy, particularly in the deregulation of interest rates and the ending of directed credit; (vii) adequacy of the regulatory framework to enforce and monitor (vi); (viii) current institutional structure of the banking sector, from the operational, oversight, and competitiveness considerations; and (ix) adequacy of corporate governance and disclosure standards in the banking sector.

9. On the basis of such study and inputs from the international specialist on regulation and governance strategy, the consultant will (i) formulate a banking strategy that sets out an action plan laying down the pace and sequence of the reform over the short, medium, and longer terms; (ii) provide policy and measures required to implement the action plan; and (iii) suggest an implementation program for strengthened governance both at the Central Bank and commercial bank levels. To ensure that the banking sector reform strategy formulated under component A is consistent with and relevant to the prevailing practical situation in Uzbekistan's banking sector, the team leader of component A will closely interact with team leader of component

B and integrate the findings of component B. In undertaking this study of the banking sector and recommendations for reform, the team leader will assume responsibility for imparting practical and on-the-job training, especially in banking restructuring, to the staff of CBU and other concerned government-owned banks. MOF will nominate the trainee candidates for this coverage.

**b. International Specialist–Regulation and Governance Strategy
(2 person-months)**

10. The consultant will have an advanced degree in law and/or accountancy and experience in (i) the introduction of improved corporate governance standards in a transitional economy, (ii) prudential supervision of commercial banks in a regulatory capacity, and (iii) corporate governance in a commercial bank.

11. As input to the banking sector strategy, the consultant will (i) review the existing banking supervision and corporate governance (by the boards) processes in commercial banks and suggest measures to improve the transparency of financial disclosures and supervision processes; (ii) study the pattern of Central Bank regulatory oversight of commercial banks, identify complementarities between (i) and (ii), and suggest measures for integrating the two; and (iii) assist the team leader in undertaking the former's assignments (paras. 7 and 8).

**c. Domestic Consultant–Reforms, Restructuring, and Governance
(6 person-months)**

12. The consultant will have an excellent working knowledge of English and experience in banking supervision and/or corporate governance. Out-of-the-country practical training in these disciplines will be preferred.

13. This consultant's terms of reference will include but will not be limited to, the following:

- (i) study the existing policy framework in Uzbekistan relating to banking supervision at the Central Bank level, and financial disclosure and corporate governance practices at the individual bank level and specify the areas needing improvement;
- (ii) prepare for the international team a sequenced policy matrix of regulatory and managerial reforms necessary for enhanced efficiency of the banking system's intermediation;
- (iii) gather data needed by the team leader and other international consultants and translate the necessary documents into English; and
- (iv) perform any other assignment as instructed by the team leader.

2. Part B

a. Team Leader/International Banking, Credit and Risk Management Specialist (6 person-months)

14. The team leader will have strong commercial banking experience in a major international commercial bank with substantial expertise in credit appraisal, risk management, and the law and practice of banking; and practical experience in introducing best international practices in

credit management, portfolio management, and risk management. Regulatory and supervisory experience and/or prior experience in introducing best international commercial banking practices in commercial banks in transition economies will be preferred. A working knowledge of Russian will be desirable. The team leader will be responsible for the output delivered by the entire team. The team leader will be individually responsible for undertaking the following activities:

- (i) **Enhancing credit appraisal systems of the two banks.** The team leader will
 - (a) assess the banks' credit appraisal capabilities, i.e., review a specified number of samples of project appraisals completed and approved; and assess the quality of the project appraisals accomplished in terms of the credit investigation, and analysis of the technical, marketing, financial, and management aspects of the projects;
 - (b) assess the quality of the banks' loan processing methodology, i.e., assess the coverage of the loan processing procedures employed, earnings prospects and ability to repay from earnings, investment by others and the character of the investment and security offered, and judgment reached on the credit worthiness of the loan proposals;
 - (c) assess the banks' postdisbursement loan monitoring and credit recovery processes, i.e., review the legal framework for loan recovery and assess the adequacy of the banks' recovery procedures in this context, so as to ensure that the banks' new lending on becoming universal will also remain sound;
 - (d) based on the observation on the findings of the previous paragraph, identify the areas in the two banks' project appraisal, loan processing, and project monitoring methodologies, the policies and procedures that need to be improved and propose amendments; and in collaboration with the domestic bank credit and bank risk management specialists, assess the existing internal controls in support of the various stages of the project cycle and develop new improved methods;
 - (e) recommend sectoral and single borrower loan concentration limits for new sectors as well as the existing ones;
 - (f) recommend appropriate information technology to the two banks for credit appraisal and credit decision making to improve the quality and speed of credit decisions; and
 - (g) With the assistance of the bank credit specialist, assume overall responsibility for training the two banks' staff in credit appraisal and loan recoveries.

- (ii) **Enhancing the risk management of the two banks.** The team leader will assess the adequacy of the banks' risk management and early warning systems, particularly in light of their increased activity resulting from the broadening of their scope, and recommend suitable measures thereof. Particularly, this area will cover lending, securities trading, foreign exchange trading, and portfolio management.

b. International Consultant/Bank Accounting, Internal Controls and Corporate Governance Specialist (6 person-months)

15. The consultant will possess (i) a professional accounting qualification, (ii) expert knowledge in the law and practice of banking, and (iii) substantial experience in banking, accounting, auditing (both internal and statutory), management information systems, and corporate governance. Regulatory and supervisory experience in these areas will be an added qualification.

16. The consultant will

- (i) assess the adequacy of internal controls in relation to credit policies (i.e., separation of powers of appraisal, approval, and supervision, and proper authority for approval of loans depending on their size), treasury management, (separation of the powers of the dealing and settlement functions);
- (ii) determine whether the banks have independent (from appraisal) internal assessments within the bank for valuing collateral, documentation for their registration in favor of the banks, and their legal enforceability;
- (iii) assess the adequacy of the banks' management information systems and determine whether all transactions are posted promptly and whether the board is fully informed in a timely manner of the banks' transactions and performance;
- (iv) assess the adequacy of the banks' internal audit systems in terms of the competence, independence, and integrity of the internal auditors, and the adequacy of the reporting arrangements to the banks' boards and the actions taken by the latter on the reports of the internal auditors. The team leader will recommend appropriate changes to the banks' reporting systems to suit their new environment;
- (v) assess the feasibility of the banks' providing quarterly results to their stakeholders as a prelude to their ultimate privatization;
- (vi) assess the existing practices in the commercial banks for interest accruals, portfolio classification, and loan loss provision; and recommend improvements to bring them in line with international practice; and
- (vii) seek to recast the two banks' 1999 balance sheets and income statements based on adjustments in (vi).

c. Domestic Consultant–Credit Appraisal (6 person-months)

17. The domestic bank credit specialist will have (i) an excellent working knowledge of English; (ii) practical commercial banking experience in credit appraisal for project financing, trade financing, and working capital finance; and (ii) regulatory and/or supervisory experience in assessment of loan quality. Out-of-country training or working experience in a market economy outside Uzbekistan will be preferred.

18. The specialist will assist the team leader in all matters relating to credit appraisal listed in the team leader's terms of reference. In addition, the consultant will undertake the following activities:

- (i) review the structure(s) of the two banks' organizational units tasked to carry out project appraisals, process loan applications, and monitor projects during implementation, start-up, and commercial operations up to full repayment, and assess the internal controls;
- (ii) review the banks' existing written procedures for lending to enterprises, written credit policies and guidelines; and identify gaps or areas where improvements may be initiated;
- (iii) review the bank's credit appraisal departments' staffing capabilities, identifying gaps or overlaps in staff skills and qualifications, and carrying out appropriate training to remedy these problems; and
- (iv) elaborate a capacity-building proposal including training in credit appraisal and post-approval recovery in light of increased and diverse sectoral exposure as the two banks move to universal commercial banking practice.

d. Domestic Consultant–Risk Management (6 person-months)

19. The domestic bank risk management, internal control, and risk management specialist will have (i) excellent working knowledge of English; (ii) an accounting degree or diploma; (iii) experience with a commercial bank in internal audit, management information systems, and internal controls; and (iv) regulatory experience in banking supervision in (iii) and (iv) above. Out- of-country training or experience in a market economy in the above areas will be preferred.

20. The consultant will assess the two commercial banks' risk management systems with particular reference to credit risks, credit concentration risks (sector-wise and borrower-wise), systems risks, exchange risks and counterparty risks both presently and on the banks' conversion to universal commercial banks; and recommend country-specific measures to mitigate these risks. The consultant will assist the team leader/international banking, credit and risk management specialist in (a) to (g) of the latter's assignments.

e. Domestic Consultant–Bank Accounting, Internal Control and Cooperation (6 person-months)

21. The consultant will need (i) a professional accounting background; (ii) excellent working knowledge of English; and (iii) experience in bank accounting, internal and/or external auditing, and banks' financial disclosure and corporate governance practices.

22. The consultant's terms of reference will include but will not be limited to, the following tasks:

- (i) assess the checks and balances within a bank to ensure their adherence to fiduciary responsibilities, and recommend suitable changes if required;
- (ii) assess the adequacy of the quality, reliability, and timeliness of the information reported by the banks' internal auditors (particularly relating to potential liabilities, risk, and financial irregularities) to the audit committees constituted by the banks' boards, and recommend specific improvements where required;
- (iii) assess the independence, integrity, and competence of the audit committee (if any) of the board of directors, assess the adequacy of the frequency of its meetings;
- (iv) assess the adequacy of the minutes and reporting of the committee to the entire board and the banks' shareholders and depositors, and recommend improvements if required;
- (v) assess the adequacy of the board's supervision of the banks' management and officers to prevent unsound banking practices, assess the management's code of ethics, if any, and recommend suitable changes if required; and
- (vi) assess the adequacy and transparency of the banks' financial disclosure and corporate governance practices and recommend suitable improvements where warranted.

COST ESTIMATES AND FINANCING PLAN
(**\$**)

| Item | Foreign Exchange | Local Currency | Total Cost |
|---|-----------------------------|---------------------------|-----------------------|
| A. ADB Financing | | | |
| 1. International Consultants | | | |
| a. Remuneration | 500,000 | — | 500,000 |
| b. Subsistence and Per Diem | 144,000 | — | 144,000 |
| c. International Travel | 20,000 | — | 20,000 |
| 2. Domestic Consultants | | 78,000 | 78,000 |
| 3. Equipment and Office Supplies | 57,000 | — | 57,000 |
| 4. Translation Expenses | 7,000 | — | 7,000 |
| 5. Communications and Reports | 20,000 | — | 20,000 |
| 6. Contract Negotiations ^a | 12,000 | — | 12,000 |
| 7. Books and Other Reference Materials | 12,000 | | 12,000 |
| 8. Contingencies | 138,000 | 12,000 | 150,000 |
| Subtotal (A) | 910,000 | 90,000 | 1,000,000 |
| B. UBA Financing | | | |
| 1. Office Accommodations | — | 20,000 | 20,000 |
| 2. Local Counterpart Staff | — | 10,000 | 10,000 |
| 3. Seminar, Training | — | 30,000 | 30,000 |
| 4. Interpretation | — | 30,000 | 30,000 |
| 5. Local Transportation | — | 12,000 | 12,000 |
| 6. Contingencies | — | 15,000 | 15,000 |
| Subtotal (B) | | 117,000 | 117,000 |
| Total | 910,000 | 207,000 | 1,117,000 |

— = magnitude zero.

ADB = Asian Development Bank, UBA = Uzbekistan Banking Association.

^a Provision is made for four Government observers to attend contract negotiations: one from the Government (for Component A), one from each of the two banks, and one from the Executing Agency.

Source: Staff estimates.